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Developing and maintaining a useful Financial Management Handbook for Department of Defense financial managers

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THESIS

DEVELOPING AND MAINTAINING A USEFUL FINANCIAL MANAGEMENT HANDBOOK FOR DEPARTMENT OF DEFENSE FINANCIAL MANAGERS

by

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December 1999

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The 13-week *Financial Management in the Armed Forces* and the two-week *Practical Comptrollership* are two classes offered at the Naval Postgraduate School, Monterey, California. The primary instructional material used for these two courses is the *Practical Comptrollership* handbook. As new financial management directives and guidance from the Office of Management and Budget (OMB), the Department of Defense (DoD), and the Department of the Navy (DoN) are implemented, financial management in the DoN is modified. The purpose of this research was to update the material contained in the *Practical Comptrollership* handbook to reflect changes in financial management policies and practices. This research investigated legislation, OMB, DoD, and DoN directives and budget guidance to incorporate the latest financial management information and processes. This research provides the most up-to-date information currently available to financial managers to assist them in improving the efficiency of financial systems and reduce costs.

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DEVELOPING AND MAINTAINING A USEFUL FINANCIAL MANAGEMENT HANDBOOK FOR DEPARTMENT OF DEFENSE FINANCIAL MANAGERS

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ABSTRACT

The 13-week *Financial Management in the Armed Forces* and the two-week *Practical Comptrollership* are two classes are offered at the Naval Postgraduate School, Monterey, California. The primary instructional material used for these two courses is the *Practical Comptrollership* handbook. As new financial management directives and guidance from the Office of Management and Budget (OMB), the Department of Defense (DoD), and the Department of the Navy (DoN) are implemented, financial management in the DoN is modified. The purpose of this research was to update the *Practical Comptrollership* handbook to reflect changes in financial management policies and practices. This research investigated legislation, OMB, DoD, and DoN directives and budget guidance to incorporate the latest financial management information and processes. This research provides the most up-to-date information currently available to financial managers to assist them in improving the efficiency of financial systems and reduce costs.

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I. INTRODUCTION

A. PURPOSE

The purpose of this research is to examine and track the changes in the primary Department of Defense (DoD) and Department of the Navy (DoN) financial directives, and the related responsibilities and duties of financial managers. The information will be used to update the existing "Practical Comptrollership" handbook. This handbook is currently being used for the graduate level course *Financial Management in the Armed Forces (MN3154)* and the two-week Practical Comptrollership course. Both of these courses are taught at the Naval Postgraduate School, Monterey, California.

The DoD's financial structure is a complicated and dynamic system that is dependent on numerous financial inputs from various defense agencies and services. As discretionary funding becomes increasingly scarce, the competition for funding among defense agencies and branches of the Armed Forces intensifies. A key player in the DoD's budget formulation and execution process is the financial manager. Understanding that each defense agency and branch of the Armed Forces have their own unique budgetary process, this research will emphasize the Navy's budgetary system.

The information on financial management guidelines and procedures is available in various directives and policies. These resources will be researched and compiled to create an easy-to-use reference designed for officers in the mid- to senior-grade levels. The updated "Practical Comptrollership" handbook will provide the financial manager with practical information and current financial management concepts.

The focus of this research is develop a reference handbook designed for Naval officers with the subspeciality code 0031P who may have limited experience in the financial management field outside of their graduate level education at the Naval Postgraduate School.

B. SCOPE

The scope of this research is to examine the current DoD budgetary guidance and the Planning, Programming and Budgetary System (PPBS), and summarize their impact on the financial management processes of the DoD and the DoN. This research will provide a brief overview of the financial management role in the DoD, emphasizing the financial management strategy of the DoN. The products of the research provide updated financial management information, which will ultimately be reflected in the "Practical Comptrollership" handbook.

C. METHODOLOGY

The methods for obtaining information for this thesis included a literature search as well as personal and phone interviews. The literature search consisted of reviewing legislative and administrative guidance, DoD Financial Management Regulations, the DoN Financial Management Guidebook for Commanding Officers, Office of Management and Budget (OMB) Circular Number A-76: Performance of Commercial Activities, and finally, articles related to various governmental financial reports and briefs.

Personal and phone interviews were conducted with personnel assigned to Under Secretary of Defense (Comptroller) and Naval Postgraduate School Comptroller organizations. These interviews focused on the budget formulation processes and execution of funds.

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II. CURRENT BUDGETARY STATUTES AND OMB CIRCULAR NO. A-76

The purpose of a comptroller is to fulfill the role as the financial manager and serve the command authority as a financial specialist. To properly function as a command comptroller, an individual needs to be familiar with all relevant the budgetary statutes. Historically, the federal government has implemented program reforms to improve the budget formulation and execution processes. This research will highlight the following major legislative and administrative guidance:

- Federal Managers' Financial Integrity Act (FMFIA) of 1982;
- Chief Financial Officer (CFO) Act of 1990;
- Government Performance and Results Act (GPRA) of 1993;
- Government Management Reform Act (GMRA) of 1994;
- Federal Financial Management Improvement Act (FFMIA) of 1996; and
- Office of Management and Budget (OMB) Circular Number A-76: Performance of Commercial Activities.

There is a plethora of legislation which has been enacted to guide financial managers. Key legislation included the Congressional Budget and Impoundment Control Act of 1974, the Balanced Budget and Emergency Deficit

Control Act of 1985, and the Budget Enforcement Act (BEA) of 1990. The Congressional Budget and Impoundment Control Act of 1974 mandated a budget process which created a framework for congressional budget decisions. The Balanced Budget and Emergency Deficit Control Act of 1985 is commonly known as the Gramm-Rudman-Hollings Act, or GRH-I. This Act set deficit targets to decrease the deficit for each fiscal year. The ultimate goal which GRH-I was attempting to achieve was to balance the federal budget by 1991. When Congress determined that the federal budget would not be balanced by 1991, they amended the GRH-I with the Amendment to the Balanced Budget and Emergency Deficit Control Act (GRH-II) in 1987 and extended the balanced budget deadline to 1993.

The BEA of 1990 implemented numerous changes to the budget process required by GRH-I and GRH-II. The thrust of the BEA of 1990 was to control the growing deficit by mandating congressional spending and revenue controls. Unlike the GRH-I and GRH-II, the BEA of 1990 was not required to balance the budget at a specific date; rather, under the BEA of 1990, Congress is prohibited from violating the discretionary spending caps or the PAYGO rule used to control entitlement spending and tax expenditures. The discretionary spending caps are ceilings for annual appropriations. Appropriations are the process by which

Congress provides budget authority, authorizing the disbursement of funding for a specific purpose (OMB, 1999).

When BEA of 1990 was initially enacted, the three discretionary spending categories for fiscal years 1991 through 1993 were defense, domestic and international. The original BEA of 1990 provided for separate discretionary spending caps for the first three years and consolidated the discretionary spending caps for fiscal years 1994 and 1995.

As the BEA of 1990 continued to evolve, new discretionary spending categories were taken into consideration. One of the new discretionary spending categories was the violent crime reduction trust fund. For fiscal years 1998 and 1999, the three individual discretionary spending categories are defense, violent crime reduction, and all other nondefense discretionary spending. In fiscal year 2000, the defense and nondefense categories will be merged, resulting in a single discretionary spending category for fiscal years 2001 and 2002 (GAO, July 1999).

If Congress breaches a spending cap, sequestration would only occur within the appropriation that violated the pre-set spending cap (Doyle and McCaffery, 1991). Sequestration is defined as the cancellation of spending authority, acting as a disciplinary tool to avoid spending above pre-established limits for discretionary spending.

Another major enforcement mechanism under BEA of 1990 is the pay-as-you-go procedure (PAYGO). The PAYGO restriction is applied when Congress implements changes in taxes and mandatory spending (e.g., Medicare and food stamps). Entitlement increases and/or tax cuts must be funded by cuts in entitlement programs or tax increases (Oleszek, 1996).

This research does not cover all financial management laws. One advantage of the list of laws on the first page of this chapter is that it allows the financial manager to gain valuable insight into what regulates the DoD financial process. The legislative and administrative guidance is described in detail in Appendices A-F.

In the future, there is the likelihood that the legislation listed on the first page of this chapter will be modified or supplemented with new legislation. Through the enactment of new legislation, Congress seeks to optimize scarce resources, to lower the costs of government and improve financial management processes. Moreover, constant review and evaluation of current legislation is needed to develop and modify strategic plans for each component (GAO, 1998).

III. AN OVERVIEW OF THE PLANNING, PROGRAMMING, AND BUDGETING SYSTEM, THE BUDGET FORMULATION AND EXECUTION PROCESSES

This chapter is designed to introduce the Department of Defense's (DoD) Planning, Programming and Budgeting System (PPBS), the Department of the Navy's (DoN) budget formulation and the budget execution processes. Appendices G, H, and I will provide the reader with detailed outlines of the three topics mentioned above.

The PPBS is the primary resource management, decision making, and allocation system of the DoD. As the name indicates, the PPBS is divided into three formal phases: Planning, Programming, and Budgeting. The purpose of the PPBS is to produce a plan, a program, and ultimately the DoD's budget. Prior to providing input to the DoD's budget, the DoN has its own process to formulate its budget for a given fiscal year.

The purpose of the DoN's budget formulation process is to forecast cost for each program, produce budget exhibits, and forward the exhibits through the appropriate channels for review and approval. Like the PPBS, the DoN's budget formulation process is a dynamic process. The products produced during the DoN's budget formulation must adhere to specific deadlines in order for the DoN's budget information to be incorporated in the DoD's budget.

The budget execution process is summarized to explain how appropriations are distributed throughout the DoD and the DoN. In addition, Appendix I will highlight major players of the budget execution phase, and lastly, discuss some of the laws that financial managers must follow to properly execute appropriations.

As previously mentioned, Appendices G, H, and I will provide the reader an outline of how the DoN generates its requirements, formulates its budget, and executes its appropriations. The primary references used to write Appendices G, H, and I were the *DoD Financial Management Regulations* and the *DoN Budget Guidance Manual*.

IV. THE MAJOR FINANCIAL ACTIVITIES OF THE DEPARTMENT OF THE NAVY

The Department of the Navy (DoN) is a very diversified organization that is supported by various internal and external financial components. These financial components have a significant impact on the execution and recording of the DoN budget. This chapter is intended to highlight the major components activities that affect the execution of the DoN budget. Appendicies J through M will provide the reader with detailed descriptions of the following:

- Appendix J - Defense Finance and Accounting Service (DFAS);
- Appendix K - Civilian Personnel;
- Appendix L - Department of the Navy's Working Capital Fund (NWCF); and
- Appendix M - Property Accounting.

Appendix J provides an overview of the Defense Finance and Accounting Service (DFAS) and the significant role it plays in the DoN organization. The purpose of DFAS is to streamline the DoN's accounting and financial responsibilities. Morever, DFAS is to reduce the Navy's financial and accounting costs and enhance the DoN's efforts to comply with the accounting reform acts (e.g., the Chief Financial Officer Act of 1990, the Government Management

Reform Act of 1994, and the Federal Financial Management Improvement Act of 1996).

Appendix K details the costs associated with civilian personnel. This appendix provides the reader with a summary of the various benefits (and their costs) civilian employees are entitled to when working for the federal government. It is crucial that financial managers are familiar with the applicable laws and guidelines to ensure civilian employees' rights and benefits are not violated.

Appendix L summarizes the purpose of the DoN's Working Capital Fund. In addition, this appendix explains how the Working Capital Fund functions as a cost saving mechanism and delineates the major problems associated with managing it.

Appendix M outlines the DoN's property accounting classifications and summarizes its utilization in tracking of real and personal property. As an effort to increase the DoN's capability to maintain book accountability, monitor equipment utilization, and schedule preventative maintenance, the automated Defense Property Accountability System (DPAS) has been implemented. DPAS is an independent system that provides the system user pertinent information concerning property and equipement management.

In conclusion, Appendices J through M provide the reader with a detailed overview of the organization and activities that have a major impact on financial operations within the DoN. The information covered in these appendices exposes the reader to important financial activities which take place within the DoN. The roles of these major component activities and execution areas have been explained in detail in the appendices listed above.

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V. CONCLUSIONS AND RECOMMENDATIONS

A. CONCLUSIONS

The information detailed in this thesis is intended to provide financial managers with a useful reference tool pertaining to important financial aspects of the Department of the Navy (DoN). The intent of this research was to summarize and outline the major Department of Defense (DoD) and DoN directives, policies, and procedures related to financial mangement. Moreover, the information provided in the appendices will be used to update the *Practical Comptrollership* handbook which is currently used in the *Financial Management of the Armed Forces (MN3154)* course and the two-week *Practical Comptrollership* course taught at the Naval Postgraduate School, Monterey, California.

The legislation noted in Appendices A through E detail the importance and purpose of each act, and how it affects financial management within the DoD and the DoN. Although legislation is regularly passed to direct financial managers, the legislation provided in these appendices is intended to highlight the budget acts that regulate the DoD financial process.

Appendix F provides the reader a summary of the Office of Management and Budget (OMB) Circular Number A-76: Performance of Commercial Activities. As the government seeks new methods of cutting cost and increasing efficiency, OMB Circular Number A-76 was implemented as administrative guidance to determine whether commercial activities should perform under contract with commercial sources, or in-house using government facilities and personnel.

In Appendix G, the Planning, Programming, and Budgeting System (PPBS) overview delineates how the DoD and the DoN allocate its resources. The PPBS process estabilishes the framework and the mechanism for decision-making for the DoD's future, and provides the opportunity to re-examine prior decisions based on changes in the present global and domestic environment. The PPBS process is extremely complicated, but it ensures that the development of a defense strategy is within fiscal constraints.

In Appendix H, the DoN's budget formulation is outlined to identify the major players and the budget formulation process. The budget formulation process is an intricate part of the PPBS process because it determines the cost of the programs approved in the Programming phase.

In Appendix I, the budget execution process is summarized to delineate how funds are distributed and spent within the DoN. In addition, key legislation (e.g., Anti-Deficiency Act) associated with budget execution is identified to emphasize the importance of proper execution of federal funds.

In Appendices J through M, overviews of the DoN's major financial activities are provided. Detailed overviews of the Defense Finance and Accounting Service (DFAS) as well as programs (e.g., Civilian Personnel, the DoN's Working Capital Fund, and Property Accounting) are provided. The DFAS organization and activities have a significant impact on financial operations within the DoN. The DoN is a diversified organization that relies on the support of the DFAS and internal financial components. These financial components have a major impact on the execution and recording of the DoN budget.

In an operating environment of limited resources, the DoN is continually challenged with seeking out new methods to minimize losses from waste and fraud, as well as increasing productivity. As the environment changes, the DoN's mission must also change to address new threats and preserve the United States' presence as a world superpower. The DoN's mission cannot be accomplished without the direct involvement of the financial manager. Sound financial management practices will always be needed to ensure that the DoN optimizes its resources.

B. RECOMMENDATIONS

This research was intended to validate and update the information contained in the *Practical Comptrollership* handbook. Future research of DoD and DoN financial management policies and procedures should be continously conducted to ensure the information contained in this handbook is current.

The topics contained in the *Practical Comptrollership* handbook emphasize some of the DoN financial management policies and procedures. The information contained in this handbook is pertinent and useful for financial managers, but members of the other Service Branches who are required to attend the *Financial Management in the Armed Forces* course are generally not familiar with most Navy terminology. Additional topics that could possibly enhance the value of the *Practical Comptrollership* handbook include examining and understanding the various financial management polices and procedures of the other Services (i.e., U.S. Army and U.S. Air Force).

The *Practical Comptrollership* handbook covers a variety of topics such as Planning, Programming, and Budgeting System (PPBS) and the Navy Working Capital Fund (NWCF). It provides the reader with overviews of these topics. Generating practical problems and solutions and incorporating them within the handbook may complement the updated information and possibly increase the student's understanding and knowledge.

As the DoD and DoN implement new financial policies and procedures, financial management in the DoN will continually change. The key to maintaining the value of this handbook is to constantly validate the information and incorporate the most recent information. The accuracy of the data collected and added to the *Practical Comptrollership* handbook will ensure its reliability and value.

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APPENDIX A. FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA) OF 1982

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 was enacted as Public Law 97-255. The FMFIA was intended to amend United States Code Title 31 laws on federal accounting, specifically, the Budget and Accounting Act of 1921 and the Accounting and Auditing Act of 1950. The focus of the FMFIA is to implement procedures specifying how executive agencies submit formal reports to the President and Congress on the effectiveness of agencies' accountability and oversight of fiscal resources and assets. Consequently, it created a formal reporting process for identifying accountability problems within each agency.

The FMFIA consists of four sections, the majority of which identify the reporting requirement for federal agencies. The first section identifies the Act by its name. The second section consists largely of new reporting requirements by which the agencies are to provide financial information to the Comptroller General. Each agency will provide "reasonable assurance" towards the safeguarding of funds and assets and accounting for and accurate reporting of funds entrusted to each agency.

In addition, this section requires the Comptroller General to enforce evaluation guidelines and in turn mandates agencies to review internal accounting and control systems. It also requires each agency to review their internal accounting and control system in order to comply with the Comptroller General's provisions. Lastly, all annual financial statements and reports will be submitted to the President and Congress, and will be made available for public distribution unless the statements and reports are classified.

The third section mandates the President to prepare a statement with each budget submission to Congress that identifies the amount of the appropriation requested for the Office of the Inspector General (IG) for each agency. Furthermore, if requested by Congress, the President must also provide information detailing the amount of funding requested by the IG for that budget cycle.

The fourth section emphasizes the requirements for each agency to include a separate report detailing whether or not the agency's accounting system meets the Comptroller General's requirements (FMFIA, 1982).

The second and fourth sections are essential in that they require agencies to identify their respectful strengths, weaknesses, and problem areas within the accountability and control system of the agency. Identified problems areas must include a plan to resolve the discrepancy and a timeline indicating completion. As for the DoD, the Secretary of Defense must submit one report which includes the FMFIA reports of the three service branches (i.e., Department of the Air Force, Department of the Army, and Department of the Navy) and all defense agencies.

As an effort to meet the requirements of the FMFIA, the DoD produced a manual titled, the *DoD Procedures For Management of Information Requirements*, DoD 8910.1-M, in June 1998. The purpose of DoD 8910.1-M is to provide guidelines for information related reports approved by the Office of the Secretary of Defense (OSD), interagency reporting requirements approved by the General Services Administration (GSA), public information required by the Office of Management and Budget (OMB), and reports required by Congress. All DoD components are required to adhere to these guidelines and produce the reports within the appropriate timeframes listed in DoD 8910.1-M (DoD Directorate for Information Operations and Reports, 1998).

The DoN has also implemented plans to comply with the FMFIA by initiating the DoN Management Control (MC) Program. The purpose of the MC Program is to evaluate current internal controls, identify weaknesses and apply solutions to improve the conditions of the internal controls that have considered to be ineffective (DoN, Office of the Assistant Secretary of the Navy, April 1999).

Based on a GAO report, *Major Management Challenges and Program Risks* dated January 1999, the DoD continues to battle with issues relating to properly accounting for billions of dollars in assets (e.g., property, equipment, inventory, and supplies) and to properly produce reliable and timely information. As a result of the DoD's inability to track these assets, the DoD's ability to produce accurate financial reports is weakened. The GAO report also states that the DoD has been unable to fully implement the financial management practices. The few recommendations that the GAO report mentioned are:

1. The DoD needs to improve the skills of its financial personnel by providing the necessary training to properly record and reconcile financial accounts;
2. The DoD needs to develop financial management systems that are integrated to decrease the complexity and the costs associated with operating the various financial systems; and
3. The DoD must effectively design a long-range plan to address how financial operations will produce reliable financial data and reports.

These are just a few of the major managerial challenges that the DoD needs to overcome in order to effectively implement the requirements mandated by the FFMIA (GAO, January 1999).

The FMFIA mandates a focused attention to accountability and control systems in order to reduce the potential for loss and to facilitate the implementation of a unified financial management system in the federal government.

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APPENDIX B. CHIEF FINANCIAL OFFICER (CFO) ACT OF 1990

The Chief Financial Officer (CFO) Act of 1990 was enacted as Public Law 101-576. The CFO Act requires the DoD and other federal agencies to improve financial reporting. This is to be accomplished by integrating accounting systems, improving internal control procedures, achieving compliance with federal accounting principles and by preparing audited financial statements.

To date, as a result of the CFO Act, Congress has determined the following:

1. The general management function of the Office of Management and Budget (OMB) requires significant change to improve the efficiency and effectiveness of the federal government.
2. The financial management function of OMB requires significant change to provide overall direction and leadership in the development of a modern federal financial management structure and associated systems.
3. Billions of dollars are lost each year through fraud, waste, abuse, and mismanagement among the hundreds of programs in the federal government.
4. These losses could have been significantly decreased by improved management, to include

improved central coordination of internal controls and financial accounting.

5. The federal government is in great need of fundamental reform in financial management requirements and practices as financial management systems became obsolete and inefficient, and does not provide complete, consistent, reliable, and timely information.
6. Current financial reporting practices of the federal government do not accurately disclose the current and probable future costs of operating and investment decisions, which includes the future need for cash or other resources. They do not permit adequate comparison of actual costs among executive agencies, and do not provide the timely information required for efficient management of programs.

The CFO Act mandates that federal agencies perform the following:

- Utilize an integrated accounting and financial management system, including financial reporting and internal controls;
- Comply with applicable federal accounting principles and standards;

- Provide information that is responsive to management needs; and
- Prepare financial statements for its revolving funds, trust funds and commercial activities (CFO Act, 1990).

Government agencies are required to submit an annual management report to Congress no later than 180 days after the end of the fiscal year. The management reports required by the Act are:

1. A statement of financial position;
2. A statement of operations;
3. A statement of cash flow;
4. A reconciliation to the budget report, if applicable;
5. A statement on internal accounting and administrative control systems by the head of federal agencies, consistent with the requirements the Federal Managers' Financial Integrity Act (FMFIA) of 1982 (Public Law 97-255); and
6. Any other comments and information necessary to inform Congress about the operations and financial condition of the corporation.

The Comptroller General of the United States can request that a federal agency provide him/her with all books, accounts, financial records, reports, files, working papers, and property belonging to or in use by that agency. Upon the completion of Comptroller General's evaluation of an agency's financial documentation, he/she will determine if an audit or review should be performed (CFO, 1990).

THE DoD CHIEF FINANCIAL OFFICER

As with all of the federal agencies involved in the CFO Act, a Chief Financial Officer has been appointed within DoD. The Chief Financial Officer of the Department of Defense (CFO, DoD) is the Under Secretary of Defense (Comptroller) (USD(C)). The USD(C) is the chief financial management policy officer of the DoD and the chief financial management advisor to the Secretary of Defense. As the CFO of the DoD, the position is responsible for overseeing financial management activities relating to the CFO Act and is responsible for developing and implementing DoD-wide financial management systems (Under Secretary of Defense (Comptroller) Homepage, 1999).

One effort that DoD has implemented to comply with the CFO Act was the establishment of the Defense Accounting and Finance Service (DFAS). DFAS was established in January 1991, changed with eliminating redundancy and reducing the cost of accounting and financial activities within DoD. Since DFAS's inception, accounting and finance systems have been reduced from 324 to 109, with a goal of 32 by the year 2003 (Lynn, May 1999).

The DoD's incremental process to integrate accounting and financial systems has been commendable, but there are still some accounting and financial issues that the DoD needs to resolve in order to be in compliance with the CFO Act. Two major hurdles that the DoD needs to address are the proper accountability of physical asset identification, and valuation and development of a comprehensive cost accounting system (GAO, January 1999).

Propelled by the driving force of the CFO Act, DoD must continue to improve its financial management systems to develop auditable financial records. As financial systems improve by producing meaningful reports and control procedures, the financial records will eventually help the DoD to improve its ability to make better financial decisions and efficiently use its resources.

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APPENDIX C. GOVERNMENT PERFORMANCE AND RESULTS ACT (GPRA) OF 1993

The Government Performance and Results Act (GPRA), also known as the Results Act, was enacted in 1993 as Public Law 103-62. This major piece of legislation was intended to reform federal government by requiring federal agencies to develop strategic plans, which describe their overall goals and objectives, and annual performance plans containing quantifiable measures of progress. In addition, federal agencies are required to submit performance reports outlining their success in meeting the standards and measures outlined in their performance plans (GAO, April 1997).

GPRA legislation was worded to help Congress deal more effectively with federal agencies. In its justification for increased oversight, GPRA states that Congress found that:

1. Waste and inefficiency in federal programs undermine the confidence of the American people in the government;
2. Federal managers are seriously disadvantaged in their efforts to improve program efficiency and effectiveness;
3. Agencies do not sufficiently articulate program goals or collect inadequate information on program performance; and

4. Congressional policymaking, spending decisions and program oversight are seriously hampered by insufficient attention to program performance and results.

The purpose of the Results Act is to:

1. Improve the confidence of the American people in the capability of the federal government by systematically holding federal agencies accountable for achieving program results;
2. Initiate program performance reform through a series of pilot projects in setting program goals, measuring program performance against those goals, and reporting publicly on their progress;
3. Improve federal program effectiveness and public accountability by promoting a new focus on results, service quality, and customer satisfaction;
4. Help federal managers improve service delivery by requiring that they plan for meeting program objectives and by providing them with information about program results and service quality;
5. Improve congressional decision making by providing more objective information on achieving statutory objectives, and on the relative effectiveness and efficiency of federal programs and spending; and
6. Improve internal management of the federal

government (GPRA, 1993).

The Results Act is primarily designed to provide Congress and policy-makers with reliable information concerning strategic plans, performance plans, and performance reports. In order to accomplish these goals, GPRA established several new requirements for federal agencies. Beginning in fiscal year 1998, agencies are now required to have strategic plans for their respective organizations. Each plan must include a mission statement, general goals and objectives, and a description of how these goals and objectives are to be achieved, evaluated, and revised (GPRA, 1993). GPRA builds on quality management and the performance measurement that many agencies have undertaken as part of their own management systems or in response to OMB requirements, the Chief Financial Officers Act, the Government Reform Act, and the National Performance Review (Rivlin, 1995).

Agencies are also required to submit annual performance plans to the OMB beginning in fiscal year 1999. These plans are intended to supplement the general guidelines of the strategic planning documents; they supply detailed descriptions of how agencies propose to administer their operations under GPRA. Executive agencies are directed to create annual performance plans that include the following:

1. Quantifiable and measurable performance goals and objectives;
2. A description the resources required to meet these goals;
3. Performance indicators designed to measure the outputs, service levels, and outcomes of activities; and
4. A basis for comparing actual results with performance goals (GPRA, 1993).

These performance plans are not intended to be overly rigid or severely constraining. Under GPRA, federal agencies will move away from simply measuring inputs and activities, and towards measuring outcomes. This change in how federal agencies are managed, it is hoped, will improve the American people's confidence in the federal government. Instead of focusing on whether an agency spent its budget in a given fiscal year, GPRA will require each agency to carefully analyze how it spends its budget, focusing on service quality and customer satisfaction (Whitaker, 1995).

According to the GAO, Congress intended GPRA to shift the focus of federal managers from processes to measurable outcomes and results (GAO, 1998). GPRA focuses top management's attention on results, which should then promote more results-oriented practices. In essence, GPRA tasks federal agencies to answer three basic planning questions:

1. What results are you trying to achieve?
2. How well are you doing? and
3. How do you know? (Hausser and Triebsch, 1996).

GPRA Benefits and Efficiencies

One of the major GPRA benefits foreseen by many members of Congress is the potential to cut back the size of the government by eliminating duplication of effort and program overlap. By requiring agencies to submit five-year strategic plans, followed by annual performance plans, GPRA will identify redundant functions and help streamline agencies subject to mission creep (Laurent, 1998).

Another potential benefit involves the ability to tie performance outcomes to budget requests. Agencies will not only be required to demonstrate the efficiency of the programs for which they are requesting funding, but must also justify specific dollar requests with performance data that shows that such funding levels are consistent with each agency's overall strategic performance plan.

In other words, agencies must show organizational successes to justify continued congressional support for their programs. This creates a competitive environment among government organizations, giving agencies the incentive to identify their Most Efficient Organizations (MEOs) and to continuously improve their activities through performance-based measurement.

One of the DoD's major responses to fulfill the requirements of the Results Act was to establish annual performance goals. The DoD's annual performance plan is a short-term approach in order to meet its long-term strategic plan. The performance goals are reviewed and ultimately, quantifiable results are produced to continually update the DoD's overall strategic plan. The outcomes of these quantifiable calculations offer the DoD vital measures relating to its ability to produce a ready force and planning strategies for the future.

The DoD's corporate goals are as follows:

1. Shape and respond - ability to shape the international environment and having a ready force that is prepared to respond to any threat; and
2. Prepare - ability to modernize its warfighting capabilities in order to overcome any future threats (Cohen, 1999a).

Despite the DoD's effort to adhere to the requirements mandated in the Results Act, it continues to struggle with the several major managerial problems that it has confronted over the past decades. The previously mentioned GAO report states that the DoD has not successfully implemented the principles of the Result Act. The DoD's strategic plan and its February 1998 performance plan were analyzed and the GAO auditors noted several deficiencies.

According to this report, the auditors recommended that the DoD needs to develop performance goals and measures with the assistance of Congress. The purpose of this effort is to ensure that the DoD's plans are thoroughly reviewed to resolve persistent problems, meet its goals and objectives, and eventually become more results oriented as required by the Results Act.

The types of deficiencies mentioned in the GAO Report are as follows:

1. The DoD's inability to locate and determine the conditions of its assets;
2. The DoD's inability to accurately report net costs of its operations and its ability to collect reliable cost information; and
3. The DoD's inability to record and reconcile accounts which impacts its ability to produce reliable financial reports (GAO, January 1999).

In conclusion, the intention of GPRA was to make radical changes in the way the government operates. It offers a systematic approach to improving efficiencies and quantifying performance-based results of federal agencies. However, its successful and timely implementation greatly depends on the willingness of Congress and the Executive Branch to reach a consensus on how GPRA should be implemented.

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APPENDIX D. GOVERNMENT MANAGEMENT REFORM ACT (GMRA) OF 1994

Congress enacted the Government Management Reform Act (GMRA) of 1994 enacted as Public Law 103-356. GMRA was implemented to gain control of federal finances. The GMRA expanded the CFO Act and requires 24 agencies to prepare annual audited financial statements. Moreover, the GMRA was created to provide a more effective, efficient, and responsive government. GMRA is divided into four titles:

I. Limitation on Pay;

II. Human Resource Management;

III. Streamlining Management Control; and

IV. Financial Management.

This appendix will focus on Title IV, Financial Management (GMRA, 1994). Title IV is divided into five sections:

Section 401. "Federal Financial Management Act of 1994;"

Section 402. Electronic payments;

Section 403. Franchise fund pilot programs;

Section 404. Simplification of management reporting process; and

Section 405. Annual financial reports.

In Section 402, electronic payments are described through amendments to Section 3332 of Title 31, United States Code. The first subsection states that after 01

January 1995 all federal wage, salary, and retirement payments will be paid by electronic transfer.

Section 403 is intentionally omitted here because of its lack of relevance to the DoD's financial management.

Section 404, the Simplification of Management Reporting Process, is intended to enhance the efficiency of the Executive Branch's performance in implementing statutory requirements for financial management reporting to Congress. The Director of OMB will identify components of executive agencies that are required to have audited financial statements. In addition, the Director of OMB will identify the form and content of financial statements.

Section 405, Annual Financial Reports, is described in Section 3515 of Title 31, United States Code. This section requires the head of each executive agency to prepare, and submit to the Director of the OMB, an audited financial statement for the preceding fiscal year. This statement must cover all accounts and associated activities of each office, bureau, and activity of the agency. Each audited financial statement of an executive agency reflects the overall financial position of the offices, bureaus, and activities and will include the assets and liabilities, and results of the financial operations of each entity.

Part of the DoD's attempt to comply with the requirements listed in the GMRA involves utilizing the assistance of the Office of Management and Budget (OMB), General Accounting Office (GAO) and the DoD audit community to generate a plan to resolve the DoD's financial reporting problems. In late October 1998, the DoD issued its first *Biennial Financial Management Improvement Plan* which highlighted various characteristics of the DoD's financial management and its strategic plan for managing its financial management operations. The purpose of the *Biennial Financial Management Improvement Plan* was to delineate the DoD's future plan for improving its financial systems. According to the GAO report, while presenting a good beginning, the DoD's Biennial Plan does not fully cover all the facets of the DoD's financial management practices, which in turn, impedes its ability to meet its long-term plan to improves its financial management performance (GAO, January 1999).

In conclusion, GMRA broadened coverage of the CFO Act of 1990 to mandate federal agencies with various fund accounts to prepare annual audited financial statements. It was intended to improve the way that the 24 agencies operate, enhance their quality of service, and promote cost saving measures.

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APPENDIX E. FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA) OF 1996

The Federal Financial Management Improvement Act (FFMIA) of 1996 was enacted as Public Law 104-208. Its purpose was to improve federal accounting practices and enhance the government's ability to provide more reliable, useful financial information. Based on congressional findings, the federal financial management system and its fiscal practices have failed to fully identify costs and accurately report its financial condition. Moreover, the current financial system has been described as being inefficient in identifying physical assets and in the evaluation and development of a comprehensive cost accounting system.

As a result of these inefficiencies, it is difficult for DoD to monitor and prevent waste, fraud, and abuse of resources. Similar to the efforts of the Chief Financial Officer (CFO) Act of 1990, the Government Performance and Results Act (GPRA) of 1993, and the Government Management Reform Act (GMRA) of 1994, FFMIA was intended to re-establish the accountability and credibility of the federal government and restore the American public's confidence (FFMIA, 1996).

FFMIA consists of several principles borrowed from other financial management-related legislation. One of the key objectives of the FFMIA is to build upon the three Acts previously established. The first Act is the CFO of 1990, which directs 24 federal agencies to improve their financial management and reporting operations. The second Act, GPRA of 1993, requires agencies to establish strategic goals, measure performance, link performance measurement with the budget, and monitor and report on goal achievement. Finally the third Act, the GMRA of 1994, addresses streamlining management control which, in turn, increases the efficiency with which agencies report to Congress. Moreover, this Act details financial management which includes simplifying management reporting, annual financial reports, and electronic payments (GAO, January 1998).

Beginning in March 1998, FFMIA mandated that auditors for each of the 24 major federal agencies and departments listed in the CFO Act of 1990 must report whether agencies' financial management systems are in compliance with Federal Financial Management Systems Requirements (FFMSR), Federal Accounting Standards (FAS), and the Standard Government Ledger (SGL) at the transaction level (FFMIA, 1996).

The FFMSR are standards for agencies to follow in developing, operating, evaluating, and reporting on financial management statements. The details for the FFMSR standards are found in OMB Circular A-127: Financial Management Systems and a series of publications titled *Financial Management System Requirements* authored by the Joint Financial Management Improvement Program (JFMIP). The purpose of the Financial Management Systems is to insure that all federal financial management systems comply with the following requirements:

- Consistent with the U.S. Government Standard General Ledger (SGL);
- Software, hardware, personnel procedures, controls, and data contained within the systems are interrelated;
- Applications of the SGL at the Transaction Level are in accordance with the Federal Accounting Standards Advisory Board (FASAB);
- Financial reporting is in compliance with the agency financial management reporting requirements;
- Budget reporting is in compliance with the Office of Management Budget (OMB) Circular A-11 (Preparation and Submission of Budget Estimates);
- Applicable functional requirements for the design, development, operation, and maintenance of financial management systems are in compliance with the Federal Financial Management Systems Requirements, and additional functional requirements are in

accordance with OMB Circulars and bulletins, and the Treasury Financial Manual;

- All security controls are in compliance with the Computer Security Act of 1987;
- Internal controls are consistent with current laws, regulations, and policies;
- Adequate training and user support are provided to all financial management systems users; and
- Maintenance is to be performed on all financial management systems on an on-going basis.

The FFMIA requires agencies to adhere to the FAS developed by the Federal Accounting Standards Advisory Board (FASAB). The Secretary of the Treasury, Director of OMB, and the Comptroller General were responsible for the establishment of FASAB in 1990. In addition, FASAB recommended a set of Government Accounting Standards (GAS) for the Federal Government.

As mentioned in Appendix B, one effort that the DoD implemented to comply with the CFO Act and the FFMIA was the establishment of the Defense Accounting and Finance Service (DFAS). The establishment of DFAS in January 1991 changed the DoD's financial and accounting methods by eliminating redundancy and reducing cost within its accounting and financial activities. Since DFAS's inception, accounting and finance systems have been reduced from 324 to 109, with a goal of 32 by the year 2003 (Lynn, 1999).

In summary, FFMIA was designed to link the CFO Act of 1990, the GPRA of 1993, and the GMRA of 1996 concurrently to enhance the overall financial reporting and accountability of government agencies. The intent of the FFMIA is increase the quality of the government by improving the federal accounting practices and enhancing the government's ability to provide more reliable, useful financial information.

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APPENDIX F. OMB CIRCULAR NUMBER A-76: PERFORMANCE OF COMMERCIAL ACTIVITIES

The DoD is constantly tasked to perform and operate in an environment of reduced budgets while still being required to maintain a high level of readiness to meet its operational missions. One method to help the DoD meet this financial challenge is to conduct a cost comparison study between commercial activities and government organizations. The Office of Management and Budget (OMB) Circular Number A-76 (Circular A-76) was implemented as administrative guidance to determine whether commercial activities should be performed under contract with commercial sources or in-house using government facilities and personnel.

Circular A-76 is a guideline intended to help increase productivity by promoting a process of competition among commercial activities and federal agencies. In addition, Circular A-76 is designed to:

- Provide a level playing field between public and private offers and generate competition;
- Allow a choice in management and performance of commercial activities; and
- Empower Federal managers to make sound business decisions.

A commercial activity is defined as an activity that may be part of an organization or a type of work that is separate from other functions and/or activities, and is suitable for performance by contract. A commercial source is a business or other non-Federal activity located in the United States, its territories and possessions, the District of Columbia or the Commonwealth of Puerto Rico, which provides a commercial product or service (OMB, 1983).

The terms, "outsourcing" and "privatization," are often used interchangeably, but there are a few subtle differences. Outsourcing involves the transfer of a function previously performed in-house to an outside provider, based on cost comparison determinations of the savings resulting from outsourcing the service. Some examples of outsourcing-types of contracts can be government-to-government, government-to-private, or private-to-private (Brower, 1997).

In contrast, according to economist Calvin A. Kent's definition, privatization "refers to the transfer of functions previously performed exclusively by government, usually at zero or below full-cost prices, to the private sector at prices that clear the market and reflect the full cost of production." Privatization involves the transfer or sale of government assets to the private sector while outsourcing does not (Brower, 1997).

Circular A-76 and its supplement have appendices to aid in making a determination of commercial and inherently governmental activities. In essence, those activities that are considered to be commercial in nature will be studied for outsourcing possibilities. Attachment A of Circular A-76 is a non-exhaustive list of commercial activities. Office of Federal Procurement Policy (OFPP) Policy Letter 92-1, "Inherently Governmental Functions," provides amplifying guidelines for determining what activities are inherently government in nature (OMB, 1996).

An inherently governmental activity is one that is so closely related to the public interest that federal employees must perform the duties (OFPP, 1992). These functions include activities that require either the exercise of discretion or the performance of value judgements in making decisions for the government. Governmental functions normally fall into two categories:

1. The act of governing (i.e., the discretionary exercise of government authority); and
2. Monetary transactions and entitlements.

Prior to considering if selected activities should be outsourced, a cost comparison study must be performed by a governmental agency to determine if each activity should be outsourced or not. The comparison process consists of six major components, as follows:

1. The development of a Performance Work Statement (PWS) and Quality Assurance Surveillance Plan (QASP);
2. The performance of a management study to determine the government's Most Efficient Organization (MEO) in order to keep the work in-house if possible;
3. The development of an in-house government cost estimate;
4. Issuance of the Request for Proposal (RFP) or Invitation for Bid (IFB);
5. The comparison of the in-house bid against a proposed contract or Inter-Service Support Agreement (ISSA) price; and
6. The Administrative Appeal Process, which is designed to assure that all costs entered on the Cost Comparison Form (CCF) are fair, accurate and calculated in accordance with Part II of the Supplement (OMB, 1996).

THE DoN's OUTSOURCING SUPPORT OFFICE

The Chief of Naval Operations (CNO) established an Outsourcing Support Office (OSO) to provide guidance and support to the Commanding Officer tasked with conducting Circular A-76 studies. The methodology that the OSO has created in order to conduct Circular A-76 studies is divided into 15 steps and is to be completed within a 12-month time frame. Since the Commanding Officer is the "owner" of the A-76 process, this 15-step process is to provide him/her with an overview that identifies the major issues related to each step of the process. The decisions made after reviewing the outcome of each process step will have a direct impact of the overall success of the Circular A-76 study. The 15-step process which is outline in Exhibit 1 and summarized below can be found in its entirety in *Succeeding at Competition*.

The first step in the 15-step process includes the development of an action plan for performing an A-76 commercial activity study. During this step, the plan of action delineates the scope of the A-76 study and generates a plan for designing the PWS, QASP, and Management Plan, and drafts a plan for data collection and analysis. The purpose of the PWS is to provide a description of the work to be conducted, performance standards, and specific deadlines. Depending on the results of the cost comparison, the PWS must be designed so that a contractor or a government in-house organization can perform the commercial activity. The QASP defines the process that the government will use to evaluate the performance of the PWS. In addition, the QASP ensure that the service provider, whether an in-house government organization or a contractor, is meeting the minimum of requirements of the PWS.

In the second step, the PWS and the QASP are developed. The development of these two documents is labor intensive and crucial to overall success of the A-76 study.

In the third step, the PSW and the QASP documents are re-evaluated and revised to reflect the most recent specifications of the study. The Commanding Officer approves the PWS and QASP and forwards it to higher authority.

In the fourth step, the PWS and the QASP are approved by higher authority. If any inputs are obtained from the next higher authority, appropriate changes are reflected in the PWS and/or QASP.

In the fifth step, the basis for developing the solicitation, request for proposal, is completed. Prior to completing the preparation for solicitation, the Commercial Activity (CA) team gathers data by conducting an informal market research. This step is made up of two research techniques. In the first research technique, the CA team interviews potential offerors and industry experts to gather primary data to determine what new techniques, successful endeavors, and forthcoming trends exist. The information obtained from these interviews with industrial experts can be included in the PWS and the Management Plan.

The second technique of conducting an informal market research is to perform literature and Internet searches. This technique provides the researcher(s) with a detailed report of the function being studied.

After the informal market research is completed, additional formal actions of the solicitation are conducted. These formal actions start with the publishing of an announcement in the *Commerce Business Daily.* The purpose of publishing an announcement is to inform private industries that the government is seeking vendors who have the capability and interest in providing the kinds of services that are the subject of the study.

In the sixth step, the development and issuance of solicitation is completed. The purpose of the solicitation is for the commercial vendors to submit their formal offers. The contracting officer, along with the CA team leader, determine which type of contract to use for the solicitation and develop the criteria to evaluate offers from the contractors.

In the seventh step, the process of developing a Management Plan is initiated. The Management Plan is generated by the in-house organization, detailing their offer to perform the service subject to procurement. The Management Plan is compared to the best value offer submitted by private industry.

The eighth step details the government's receipt and initial processing of the offers by private industry to perform commercial activities. The solicitation process is simplified by permitting offerors to inspect facilities where the commercial activities are currently being performed.

In the ninth step, the Independent Review Officer (IRO) reviews the PWS, QASP, and the Management Plan. The IRO is an individual who is assigned to an activity that is organizationally unbiased with respect to the commercial activity. The review may be conducted by contractors, audit staff, or other qualified government personnel. The independent review must be in accordance with the DoN's *Guide for Reviewing Cost Estimates Prepared Under the Commercial Activity Program.* The Management Plan is reviewed to ensure that the data contained within the plan adequately details the government's ability to perform the PWS.

In the tenth step, the contractors' proposals are reviewed and a selection of the best offer is compared to an in-house organization offer. The contracting officer reviews the offeror's proposal to ensure that deficiencies and uncertainties are nonexistent.

In the eleventh step, if negotiations are conducted, the contracting officer is responsible for determining the government negotiation objectives of each offer. In addition, the contracting officer develops the pre-negotiation clearance memorandum which delineates the government's negotiations and then forwards it to the Commanding Officer. The Commanding Officer is responsible for submitting the pre-negotiation clearance memorandum to the next higher authority for review and approval.

In the twelfth step, the contracting officer obtains additional information concerning the offerors' technical and/or cost proposal, and discussions are held between the contracting officer and the offeror to resolve any discrepancies. After the revised proposals are reviewed, the process continues into step thirteen, obtaining the final clearance approval for selecting the best value contractor proposal.

The thirteenth step is designed to serve two purposes:

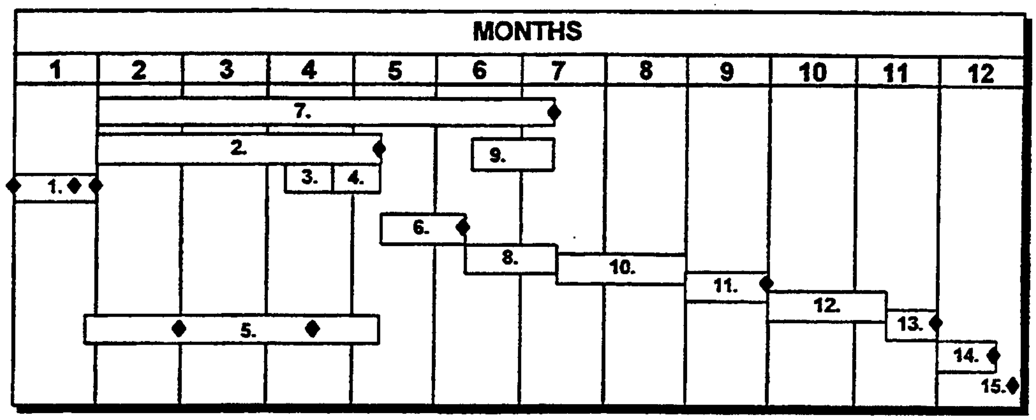
1) The contracting officer obtains the revised Best and Final Offers (BAFO), makes a preliminary selection and receives approval from higher authority; and
2) The selection of the best value contractor is documented.

In the fourteenth step, the contracting officer compares the best value contractor proposal and the government proposal in order to make a tentative selection decision. The contracting officer forwards the government's Technical Performance Plan to the Source Selection Authority (SSA) to ensure that the technical proposal requirements meet the provisions of the solicitation. Once the Technical Performance Plan has been approved by the SSA, a cost comparison between the contractor's and the government's proposal is performed. If the contractor's proposal is lower than the government's proposal by 10 percent or $10 million over the performance period, the contractor's proposal is tentatively selected. If the contractor's proposal does not meet these minimum cost savings, the MEO is then tentatively chosen to render the commercial activity.

In the fifteenth step, the tentative selection is publicized. In addition to announcing the tentative decision, the government and contractor cost estimates, performance standards, and the PWS and the Management Plan are made available to the public.

The A-76 Administrative Appeals process commences at the time of acknowledgment of the tentative decision. All appeals must be forwarded within 20 days after the announcement, or 30 days if the cost comparison is complicated. The Administrative Appeal Authority is responsible for making a final decision within 30 days of receiving the appeal (Naval Facilities Engineering Command, 1997).

Exhibit 1. A-76 Timeline



◆ Major Milestone Event

DESCRIPTION OF STEPS ON THE A-76 TIMELINE	
Step 1: Plan for Commercial Activities Study	**Step 9: Perform Independent Review**
Step 2: Develop PWS and QASP	**Step 10: Evaluate Proposals**
Step 3: Review and Revise PWS and QASP	**Step 11: Obtain Prenegotiation Clearance Approval**
Step 4: Obtain High Level Approval of PWS and QASP	**Step 12: Conduct Discussions with Offerors**
Step 5: Conduct Presolicitation Actions	**Step 13: Obtain Final Clearance Approval for Selecting Best Value Contractor Proposal**
Step 6: Prepare and Issue Solicitation	**Step 14: Compare Government and Contractor Proposals**
Step 7: Develop the Management Plan	**Step 15: Announce Tentative Decision**
Step 8: Respond to Solicitation	

The key players in an A-76 study, other than the Commanding Officer, are the contracting officer and the legal officer. The contracting officer may be useful in minimizing any possible delays and advising the Commanding Officer when to implement reforms and initiatives that may be included in the A-76 study. Because of the complexity of an A-76 study, the Commanding Officer may also need to seek legal counsel in the early stages of the study to ensure legal issues have been identified and addressed (Naval Facilities Engineering Command, 1997).

The final outcome of this process will determine whether the functions are to remain in-house, or be contracted out to a commercial activity.

Under certain circumstances, Commanding Officers may submit waivers to be exempted from performing an A-76 study. The criteria and guidelines for this waiver can found in the A-76 Supplemental Handbook. Only a designated official may grant a cost comparison study to be waived or transfer the in-house service to another activity through the process of using an Inter-Service Support Agreement (ISSA) (Naval Facilities Engineering Command, 1997).

The theory behind outsourcing for certain governmental activities is that the government will operate more like a business and be better managed. As a result, money will be saved as federal organizations outsource their selected activities for more cost savings. Outsourcing provides competition in government activities, challenging and motivating government and military agencies to discover the most cost effective and efficient means of accomplishing their missions.

APPENDIX G. THE PLANNING, PROGRAMMING, AND BUDGETING SYSTEM (PPBS)

The Planning, Programming, and Budgeting System (PPBS) was introduced to the DoD in 1962 during Secretary of Defense (SECDEF) Robert McNamara's term in office. The PPBS concept was developed and implemented by Charles J. Hitch, the Assistant Secretary of Defense (Comptroller) during fiscal year 1963. The PPBS is used by all the components of the armed forces and translates a finite amount of fiscal resources into the best mix of forces, equipment, and support to the combatant commanders. In addition, the PPBS is designed to assist the SECDEF in making choices about the allocation of resources among a number of competing or possible program alternatives to accomplish specific objectives of our national defense (McNamara, No date).

The PPBS process operates on a year-round cycle although not simultaneously with the fiscal year. The process begins with a broad planning phase, which then is narrowed down to definitive program objectives, and lastly into specific budgetary estimates that detail the cost of the programs.

The PPBS establishes the framework and the mechanisms for decision-making for the future, and provides the opportunity to re-examine prior decisions based on changes in the present global and domestic environment such as the changing economic conditions and emerging threats. The PPBS is a cyclical process that consists of three unique but interconnected phases:

1. A **planning phase** which assesses the global threats and develops defensive strategies to deter the potential threats.

2. A **programming phase** which translates the strategic plans into programs defined in terms of forces, personnel, material, and dollars.

3. A **budgeting phase** which expresses the programs in terms of biennial funding requirements (Naval Postgraduate School, 1999).

Figure 1 illustrates the Navy's PPBS process.

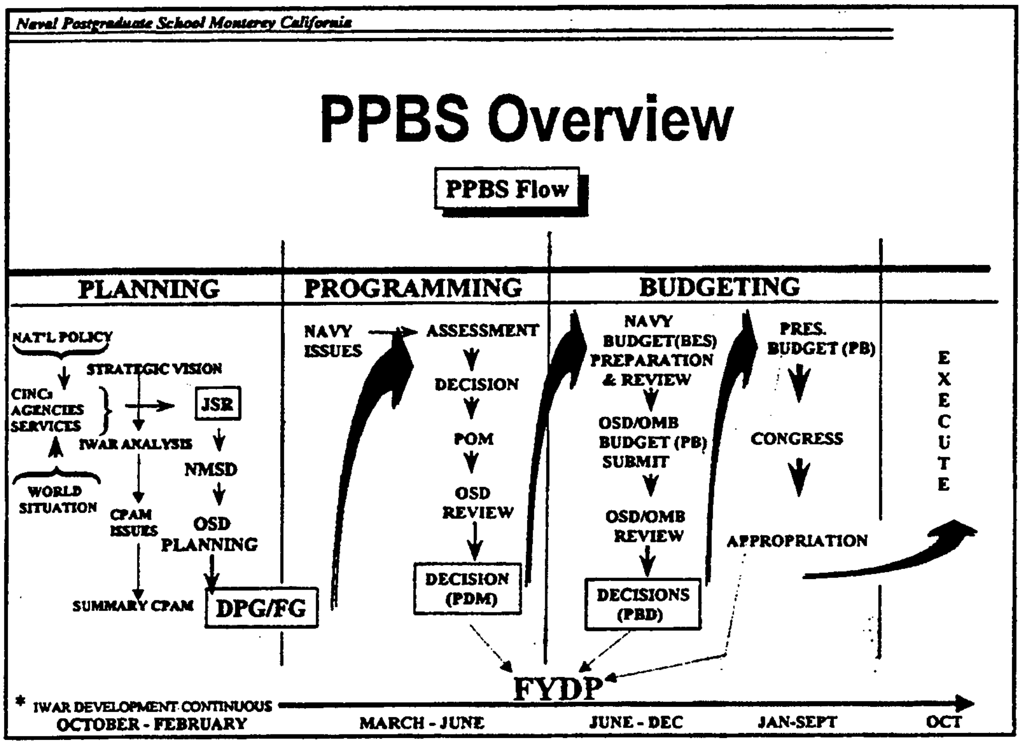


Figure 1 - The PPBS Cycle

Future Years Defense Program (FYDP)

The Future Years Defense Program (FYDP) is the DoD's most crucial management tool in the PPBS process. The DoD uses the FYDP as an internal working document which contains information that summarizes all forces, resources, and equipment allocations that the SECDEF has approved for the DoD. It is, essentially, an ancillary mechanism designed to budget the defense plan for six years. In 1988 it was expanded to cover from five years to six years (Davis, 1997). The FYDP is a compilation of the Current Year (CY), Prior Year (PY), biennial budget, and four additional outyears. The biennial budgets are actually the Program Objectives Memorandum (POM). They cover two years always beginning with the even year (e.g., fiscal years 2000-2001, 2002-2003, 2004-2005, etc.). The Navy develops its POM in even-numbered years and the Program Review (PR) is conducted in odd-numbered years. The biennial budget submissions consist of the first two years of the POM and are considered the basis for the defense budget. In odd-numbered years (e.g., 1999, 2001, 2003, etc.), the Program Review (PR) occurs and the OSD requires an amended Budget Estimate Submission (BES) that provides new program estimates (Zimmer, 1997).

Table 1 illustrates the POM/PR schedule. The POM covers a six-year period, while the PR covers the last five years of the prior POM. A biennial BES is submitted in the POM years, and the second year of the prior biennial BES is updated in the PR year (i.e., 2001 is updated from the 2000/2001 submission). The BES will be covered in detail during the budget phase of this document.

CY	POM/PR										
1998	POM '00	2000	2001	2002	2003	2004	2005				
1999	PR '01		2001	2002	2003	2004	2005				
2000	POM '02			2002	2003	2004	2005	2006	2007		
2001	PR '03				2003	2004	2005	2006	2007		
2002	POM '04					2004	2005	2006	2007	2008	2009

Biennial Budget Years

Table 1 - POM/PR Schedule

The FYDP is published three different times during the PPBS cycle:

1. May - contains the Service Program Objectives Memorandum (POM) submission;

2. September - contains the Service Budget Estimate Submission (BES);

3. January - contains the President's Budget (PB) Submission (Zimmer, 1997).

The FYDP was designed with three interrelated dimensions as seen in Figure 2. On one side of the figure, the FYDP lists 11 Major Force Programs (MFPs). MFPs are the eleven general categories in which the DoD's mission is organized. The purpose they serve is for internal programming and budget tracking. In addition, the MFPs are the basic building blocks to develop Program Elements (PE). A PE is typically a seven-position alpha/numeric (it may be 10 positions long) code that identifies the type of program and is used by all players in the PPBS to monitor funding. The first two digits of the PE indicate the MFP, and the alphabetic character(s) at the end of the PE determines the specific Service (e.g., N=Navy, F=Air Force, M=Marine Corps, and A=Army) (Tyskiewicz, 1998).

On another side of the figure, the FYDP is categorized by the appropriation used by Congress when reviewing the budget requests and appropriating budget authority. In the last dimension of the figure, the FYDP demonstrates the various DoD components.

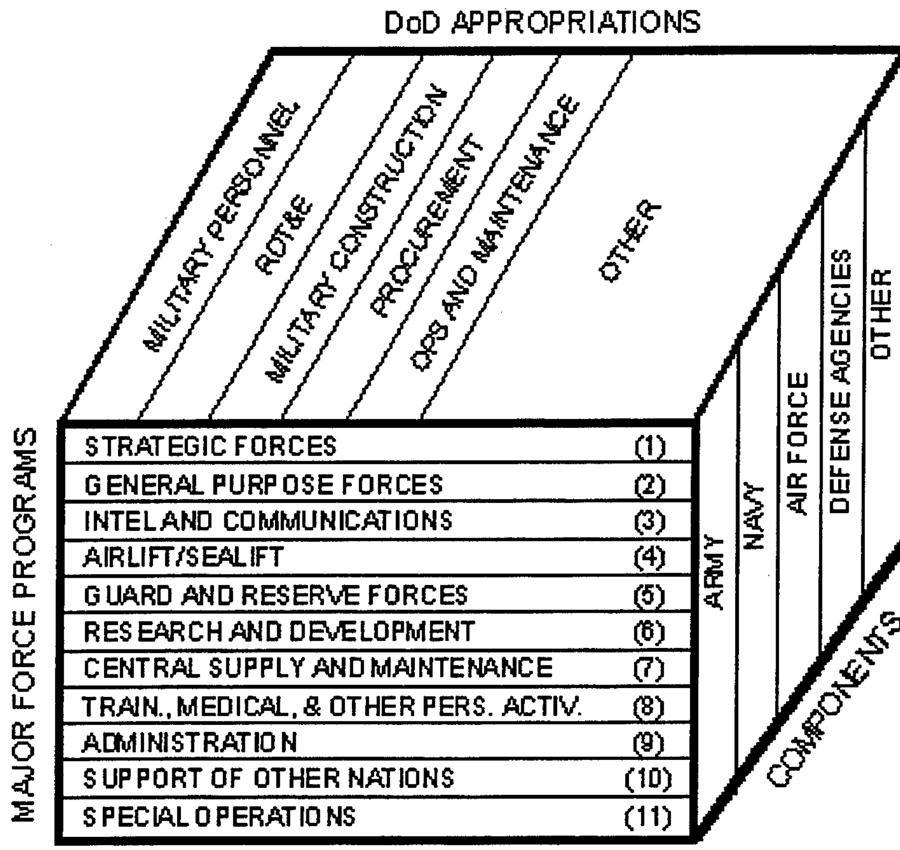


Figure 2 - Future Years Defense Program (FYDP)

The PPBS Players

The key players in the PPBS process involve representatives of the Executive Branch and Congress. This appendix will identify the members of the Executive Branch who are involved in the PPBS process and how Congress plays an important role as well. As each phase of the PPBS is explained in detail, the reader will be able to identify when and what each player contributes. The players of the Executive Branch are as follows:

1. President;
2. Office of Management and Budget (OMB):
3. Department of Defense:
    a. SECDEF;
    b. OSD Comptroller; and
    c. Assistant Secretaries;
4. Department of the Navy:
    a. SECNAV;
    b. CNO/CMC;
    c. Budget Submitting Offices (BSO);
    d. Appropriation Sponsors;
    e. Program Sponsors;
    f. Program Offices; and
    g. Resource Sponsors.

The Defense Resource Board (DRB)

The Defense Resource Board (DRB) consists of senior defense leaders who are responsible for overseeing the entire PPBS process. The role they play is significant because they are responsible for advising the SECDEF on policy, planning, programming and budget issues. In addition, the DRB reviews and evaluates high priority programs and issues on a regular basis. If any major program and budget issues arise during the PPBS process, it is the responsibility of the DRB to resolve any disagreements (DoD, 1984). The Chairman of the DRB is the Deputy Secretary of Defense and the Chairman of the Joint Chiefs of Staff serves as the Vice-Chairman. The DRB consists of the following members:

1. Under Secretary of Defense (Acquisition and Technology);
2. Under Secretary of Defense (Policy);
3. Under Secretary of Defense (Comptroller);
4. Under Secretary of Defense (Personnel and Readiness);
5. Senior Civilian Official, Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence);
6. Vice Chairman of the Joint Chiefs of Staff; and
7. The Secretaries of the military departments (Deputy Secretary of Defense, May 1999).

Phase 1 - Planning

The first "P" of the PPBS is the planning phase. This phase commences with an analysis of the *National Security Strategy of the United States* (see Figure 1). Its goal is to determine the most likely threats aimed at the United States. The President authors the *National Security Strategy of the United States.* Its purpose is to provide information on national interests, global and regional trends, as well as political, economic and defense strategies.

It is the responsibility of the senior defense offices, including the Secretary of Defense (SECDEF), the Joint Chiefs of Staff (JCS), the Unified Commanders (CINCS), and Specified Commanders to develop the Joint Strategic Review (JSR). The JSR, authored by the JCS, bridges the President's National Security Strategy and the National Military Strategy Document (NMSD).

The NMSD is authored by the Chairman of the JCS, and co-authored by the Secretary of the Navy (SECNAV), Chief of Naval Operations (CNO), Commandant of the Marine Corps (CMC), Chief of Staff of the Army, and the Chief of Staff of the Air Force. The NMSD provides advice to the President, the National Security Council, and the SECDEF for developing the national military strategy in support of national security objectives without fiscal constraints or restrictions.

After the NMSD is produced it is forwarded to SECDEF for review. The findings generated from the JSR and the NMSD will assist in the development of the Defense Planning Guidance (DPG) which is produced by the Office of the SECDEF. The DPG is issued and distributed in late March or April. The DPG provides Fiscal Guidance (FG) to the Services in order to develop their respective Program Objectives Memorandum (POM) and ultimately their budgets based on specified fiscal constraints (Tyszkiewicz, 1998). The POM will be further explained in the programming phase.

Total Obligation Authority (TOA)

The TOA is the total sum of all budget authority approved by Congress for a given fiscal year. In addition, the TOA identifies the amount of funds approved to credit specific accounts and unobligated balances of funds initiated from prior years. The TOA changes year-to-year because of the possibility of a recession, reappropriations, and unused budget authority that may occur (Tyszkiewicz, 1998). The terms recession, reappropriation, or budget authority will be further explained in the Appendix H - The Navy Budget Formulation Process.

The DoN Application of PPBS - Assessments

As the planning phase progresses with the development of the JSR, NMSD, and the DPG, the Navy is performing its own analysis of the national threats by using the Integrated Warfare Architecture (IWAR). The IWAR is the Navy's assessment process that combines the Navy's strategic vision, threat assessment, and platforms. The IWAR assesses "capabilities" vice "platforms", seeking to optimize a balance within fiscal constraints. In addition, the Navy's IWAR prioritizes its capabilities within the boundaries of the Navy Total Obligation Authority (TOA) and serves as the overall assessment for Navy programs (Director, Programming Division (N80), January 1999).

The five warfare components of the IWAR structure are: Sea Dominance, Power Projection, Deterrence, Air Dominance, and Information Superiority. The seven supporting "pillars" of the IWAR structure are:

1. Sustainment;
2. Infrastructure;
3. Manpower and Personnel;
4. Readiness;
5. Training and Education;
6. Technology; and
7. Force Structure.

Figure 3 shows the IWAR structure.

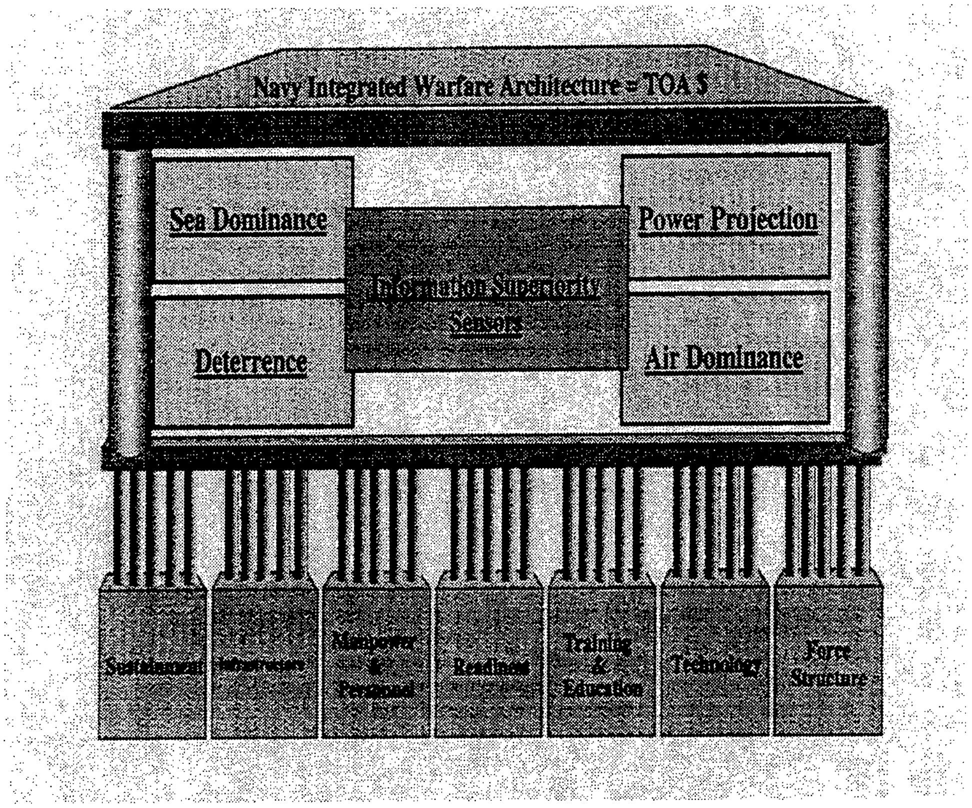


Figure 3 - The IWAR Structure

The major steps in the Navy planning process are to assess the current situation, determine military strategy and forces levels, and develop force-planning guidance. One of the Navy's key players in the planning process is the Deputy Chief of Naval Operations (DCNO) for Plans, Policy and Operations, who is coded as N3/N5. During the Planning phase, the Navy constructs its Maritime Strategy, which is the Navy's warfighting strategy. Core working groups from the Director, Assessment Division (N81) assess each of the five warfare areas and the seven support areas of the IWAR structure. The assessments of the twelve IWARs are analyzed, and the results of these assessments are published in the CNO Program Analysis Memoranda (CPAMs). The purpose of the CPAMs is to consolidate the twelve CPAMs into an integrated program to ensure that there are balanced programs across the IWAR structure, and the programs are within the acceptable fiscal limits of the Navy TOA. In addition, the CPAMs are the foundation for the Navy's Programming Guidance which outlines the impact on warfare capabilities in the short- and long-term (Zimmer, 1997).

The Director, Assessment Division (N81) reviews the CPAMs and determines if there are any possible alternatives within a program, and forwards proposed options to the Integrated Resources and Requirements Review Board (IR3B). The IR3B is comprised of the Assistant Secretaries of the Navy (ASNs) and senior Naval flag officers and Marine Corps general officers, generally at the "3" star rank. The IR3B is responsible for reviewing the CPAMs and resolving any major existing issues. Once the CPAM has been approved by the IR3B, the CPAMs are forwarded to the DoN Program Strategy Board (DPSB) (Zimmer, 1997).

The DoN's Program Strategy Board (DPSB)

The DoN Program Strategy Board (DPSB) is responsible for reviewing the CPAMs and uses the document to develop the Navy program guidance, which supplements the DPG. As delineated in SECNAV Instruction 5420.191, the DPSB is chaired by the SECNAV and the members of the board include:

1. CNO;
2. CMC;
3. Vice CNO;
4. Assistant CMC;
5. Under Secretary of the Navy;
6. General Counsel;
7. Assistant Secretary of the Navy (RD&A);
8. Assistant Secretary of the Navy (FM&C);
9. Assistant Secretary of the Navy (I&E); and
10. Assistant Secretary of the Navy (M&RA).

After the DPSB reviews the CPAMs it issues the Summary CPAM. The Summary CPAM is a collection of recommendations for the Navy's Programming Guidance and provides the guidelines for measuring the Sponsor Program Proposals (SPPs) that supplement the guidance contained in the DPG.

Phase 2 - Programming

The second "P" in the PPBS process is the Programming phase. In March, the DoD components begin to develop their six-year programs for their respective Services. The six-year plan is a management tool that assesses the DoD's missions and objectives, creates optional methods in order to achieve them, and appropriately distribute their resources. As previously mentioned, the DPG is general guidance specifying the necessary missions and demands required for defending the nation from potential threats. In areas where the DPG does not provide specific guidance to the Services, it offers the Services the opportunity to make the appropriate choices that best suit the needs of the Services (Davis, 1997).

The Services attempt to attain the optimal allocation of resources given the fiscal constraint mandated by the DPG and FG established during the Planning phase. The SECDEF specifies the distribution of the TOA to the Services via the FG. The SECNAV determines the allocation of funding between the Navy and Marine Corps, also known as the "blue/green" split.

The Key Players of the Navy's Programming Phase

The key players of the Navy's programming phase are the Assessment Sponsors, PPBS Managers, and Resource Sponsors. The PPBS Managers are responsible for keeping the process moving and optimizing compliance with the SECDEF, the SECNAV, and the CNO's guidance. Resource Sponsors are responsible for the aggregation of programs which are funded by the Navy's TOA.

The Navy manages its programming decisions through a group of executive-level boards delineated by SECNAV Instruction 5420.191 (Department of the Navy Program Strategy Board (DPSB)) and OPNAV Instruction 5420.108A (CNO Executive Decision Process). OPNAV Instruction 5420.108A establishes a framework of meetings in which significant issues to the Navy, such as programming decisions, can be decided by the Navy Review Board (NRB) and the Resources and Requirements Review Board (R3B). The Commanders' in Chief (CINC) Conferences addresses issues that have a broad impact on the Navy. Finally, the Integrated Resources and Requirements Review Board (IR3B) reviews high-interest program issues affecting both the Navy and the Marine Corps. The Vice-Chief of Naval Operations (VCNO) is responsible for the overall operation and administration of the CNO Executive Decision forums.

Deputy Chief Naval of Operations (N8) Organizational Structure

Figure 4 illustrates the organization of the DCNO for Resources, Warfare Requirements and Assessments (N8). The DCNO for Resources, Warfare Requirements and Assessment (N8) oversees the Director, Programming Division (N80), the Director, Assessment Division (N81), and the Director, Fiscal Division (N82).

N80 is responsible for managing the programming phase with the assistance of N81 and N82. N81's primary responsibility is program assessment, while N82's primary responsibility is fiscal management of the programs. N82 has a "dual-hatted" role in that N82 not only reports to the CNO, but is also responsible to the Assistant Secretary of the Navy (FM&C) as the Director of the Office of Budget (FMB). As N82, he/she is responsible for the management of the DoN's budget and ensuring that the pricing for the programs is correct. As the FMB, his/her responsibilities mirror the role as N82, but the difference is that the FMB ensures that the DoN's budget fully supports the DoD strategy to "shape, respond, and prepare" the force for the future (RADM Church, February 1999).

The purpose of the programming phase is to assess the warfare requirements, translate capabilities into definitive programs, and balance fiscal and resource constraints. This section of the PPBS produces key documents, including the following:

1. DoN Programming Guidance;
2. N80 POM/PR Serials;

3. Program Objectives Memorandum (POM); and

4. Future Years Defense Program (FYDP) - six years.

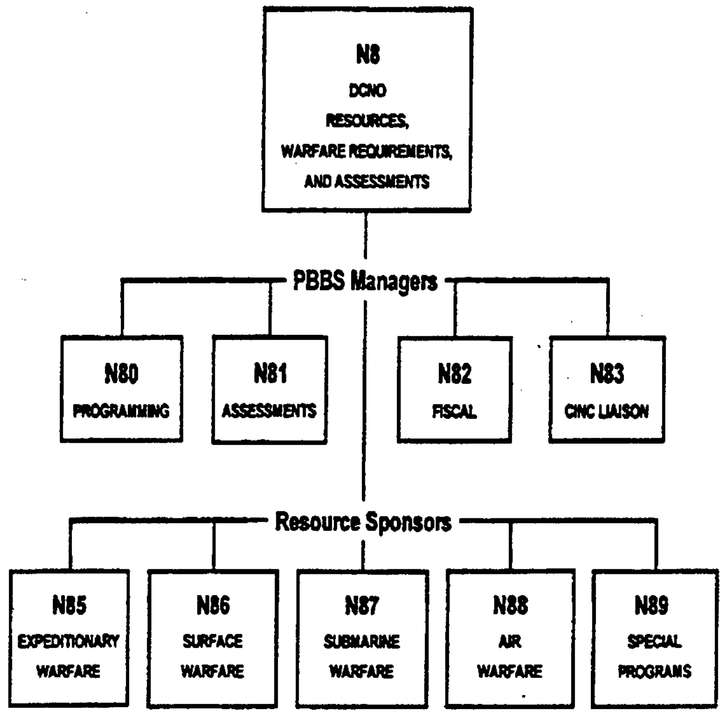


Figure 4 - N8 Organizational Chart

The DoN's Programming Guidance

The DoN's Programming Guidance takes the objectives noted in the DPG into consideration and uses them to develop the SECNAV's Programming Guidance (SPG). The SPG delineates the SECNAV's objectives for the Navy. Based on the objectives noted in the SPG, the OPNAV's Programming Guidance is produced. The OPNAV's Programming Guidance provides specific direction based on the inputs from the IWAR Integrated Process Teams, and the Summary CPAM.

The Programming Objectives Memorandum (POM) Serials

The POM Serials are also developed to provide supplemental guidance and procedural updates during the programming process. In addition, the POM Serials provide specific guidance to the Resource Sponsors for the development of the Sponsor Program Proposals (SPPs).

The first step in the development of the SPPs involves the input from the following Navy leadership:

1. N85 - CINC, Headquarters Marine Corps, Type Commander (TYCOM);
2. N86 - CINC/TYCOM liaison, semi-annual Fleet inputs;
3. N87 - Flag Board, Executive Steering Committee reviews; and
4. N6 - CINC/TYCOM liaison.

The second step requires each Resource Sponsor to address the needs and priorities of the Program Guidance, Unified CINCs' Integrated Priority Lists (IPLs), and Component Commanders' Issue Papers (CIPs). The third step is to consider the fiscal and manpower constraints (Director, Programming Division (N80) January 1999).

The Sponsor Program Proposals (SPPs)

The SPPs are considered to be the Resource Sponsor's POM submission. Prior to the Resource Sponsors forwarding the SPPs to N8, they are responsible for incorporating the programs and screening for programs that do not comply with the IWAR and CPAM analysis, redistributing the Navy's TOA among programs, and considering the CINCs' IPLs and CIPs (Director, Programming Division (N80) January 1999).

Baseline Assessment Memorandum (BAM)

Another document that supports the development of the SPPs is the Baseline Assessment Memorandum (BAM), developed by the Resource Sponsors. The BAM is the funding assessment for a specific program that provides valuable information for the development of the POM Programming Guidance, and an allocation management tool for (Director, Programming Division (N80) January 1999).

Integrated Priority Lists (IPLs)

The IPLs provide the CINCs with an opportunity to submit an unlimited number of prioritized issues as input into the programming phase. The CIPs provide the Component Commanders (e.g., the CINC Atlantic Fleet and the CINC Pacific Fleet) a means to communicate program and budgetary requirements that are significantly related to the CINCs' IPLs. The CIPs also provide detailed information concerning any program that was not addressed in a specific IPL. The CNO is responsible for responding to the CIPs via the Sponsor Program Proposal Documents (SPPDs) and the Sponsor Program Proposals (SPPs) (Director, Programming Division (N80) January 1999).

After the SPPs have been developed, the Post SPP Assessment is conducted by the CNO. The CNO performs an evaluation of the Programs via the SPPs and ensures that the SPPs are in compliance with the guidance mentioned in the planning stage. If the CNO identifies a discrepancy, it is returned to the Resource Sponsors for correction, following which the SPPs are resubmitted to CNO for reconsideration/approval.

The "End-Game"

The end result of this stage will be forwarded for further review by the internal CNO "end-game" review board. The "end-game" review board consists of the R3B and the Navy Staff Executive Steering Committee. The CNO is responsible for making the final decisions on the SPPs and the CNO and CMC develop a tentative POM (T-POM). The T-POM is submitted to the SECNAV for approval. The results of the SECNAV's decisions are included in the POM. The purpose of the "end-game" is to ensure the SPPs meet the guidelines specified in the DPG and are with in accordance with the fiscal boundaries (DoN, April 1999).

The Navy's Program Objectives Memorandum (POM)

The Navy's POM is forwarded to the SECDEF for review and approval. The POM delineates the objectives, planned activities, and cost of each program for each of the Services. The SECDEF, along with the JCS, and the CINCs perform a thorough review of the POM. The review is constructed using questions, issues, and analyses provided primarily by the Assistant SECDEF, Program Analysis and Evaluation (PA&E).

The Assistant SECDEF (PA&E) prepares issues books that highlight the major different view points of the Assistant SECDEF's staff and the Service POM submissions. The Issues Books are reviewed and evaluated by the DRB. The Issues Books may include the Service's position (reclama), CINC inputs, the Assistant SECDEF (PA&E) position and recommendations to the DRB.

The DRB reviews each of the Issue Books and provides recommendations to change the POM to the SECDEF. During this POM review process, the CINCs are given another opportunity to present their concerns to the DRB as a way to appeal the DRB's decision. In addition to the CINCs' input to the DRB, the Service Chiefs of Staff are allowed to submit a Service reclama to state their position based on the tentative decisions made by the DRB and Assistant SECDEF (PA&E) (Naval Postgraduate School, 1999).

As previously mentioned in the FYDP section of this appendix, the FYDP is the DoD's internal working document which contains information that summarizes all forces, resources, and equipment allocation with programs that the SECDEF has approved for the DoD. After the POM has been approved by the SECDEF, the FYDP is updated to ensure that the information reflects the most recent changes made by the SECDEF.

In August, the SECDEF reviews the recommendations made by the DRB and makes final decisions on each of the Service POMs and defense agencies. The SECDEF's decisions are documented in the Program Decision Memoranda (PDMs). The PDM is the final product of the programming stage of the PPBS, providing the Services with instruction on how to develop their budgets based on the decisions made in the Service POMs (Naval Postgraduate School, 1999).

The Budgeting Phase

The "B" of the PPBS is the Budgeting phase. The budget estimate submissions (BES) are the Services' budget estimates of the programs approved during the Programming phase. The purpose of the Budgeting phase is to categorize the programs by appropriation and to acquire the most recent costs associated with the approved programs, including the current inflation factors. In addition, it provides detailed guidance to the budget submitting organizations to facilitate preparation and submission of their respective budget estimates (DoN, April 1999).

The conversion of the POM to the DoD's budget equates to identifying the amount of dollars needed to acquire or accomplish the programs. The POM and budget formulation have a few distinct differences and it is important that the financial manager be aware of them. One difference between the POM and budget formulation is that the POM views programs as major DoN programs (i.e., macro level) while during the budget formulation the DoN programs are viewed more narrowly (i.e., micro level). Secondly, the Resource Sponsors submit gross totals for each of the programs which are noted in the POM. During the Budgeting phase, the Budget Submitting Offices (BSOs) are responsible for providing the most recent costs for each of the programs. Thirdly, as mentioned in the Programming phase, the POM is the DoD's major internal working document that supports the development of the SECDEF's Program Decision Memorandum (PDM) (Zimmer, 1997).

Budget Estimate Submissions Formulation (by BSOs)

The Budget Estimate Submissions (BES) are required when budget calls are issued by the Under Secretary of Defense (Comptroller). The budget calls mandate that the BSOs submit, on an annual basis, their updated estimates for the approved programs identified in the POM.

The Under Secretary of Defense (Comptroller) (USD(C)) issues guidance in June or July to provide specialized instructions and supporting material requirements to the BSOs. This guidance is specifically used in the development of the BES(s) (Under Secretary of Defense (Comptroller), 1998).

Navy Review

If FMB, commonly known as NAVCOMPT, disagrees with a claimant's budget submission, a mark will be issued. A mark is a proposed line item adjustment to the BSO's budget submission. Generally these proposed line item adjustments are to decrease the amount of funding for a particular program. The BSOs are responsible for responding by developing position papers, also known as reclamas. Reclamas are formal appeals to the proposed line item adjustments and they also include the BSO's justification to reinstate the original funding amount. If BSOs do not submit a reclama or obtain approval to restore the original funding amount, the BSOs are responsible for modifying their budget to show the funding amounts that were revised by the mark (Naval Postgraduate School, 1999).

Reclamas Submissions

The timeframe for BSOs to develop a reclama and submit their response to FMB is generally 72 hours or less. The budget analysts and division heads in FMB evaluate the reclamas. Any pending issues concerning the reclamas are presented to the CNO and CMC for review and then are forwarded to SECNAV for resolution. Generally the issues that are reviewed at this high level involve a large dollar value and have significant impact on the Navy's ability to perform its mission (Naval Postgraduate School, 1999).

SECDEF/OMB Review

In mid-September, the Services provide their detailed BES(s) to the SECDEF and OMB. Once the BES(s) have been compiled by the BSOs, the FYDP is updated for the second time. As previously mentioned, the FYDP is initially updated in May when the Services' provided their POM submissions.

From October to early December, analysts from USD(C) and OMB review the BES(s). The purpose of the BES review is to ensure that the estimates are in accordance with the PDM and other related guidance. During the BES hearings, any issues concerning appropriations or programs are addressed by the Services. The four major areas that the USD(C) and OMB analysts focus on when reviewing the BES(s) are:

1. Program pricing - which ensures that the prices for the programs have been done correctly;
2. Program phasing - which ensures that the timeline to complete the program is compatible with the funding to pay for the program requirements;
3. Funding policies - which ensures that the budget for the programs is in accordance with the specific appropriation categories (e.g., Operations and Maintenance (O&M) programs are annually funded, and Military Construction (MILCON) projects are funded for five years); and
4. Program and budget execution - which evaluates the efficiency of an organization to properly execute the currently available funds in order to meet its goals (Zimmer, 1997).

The reclama reviews are conducted to address issues in the Program Budget Decisions (PBD) raised by the SECDEF and

OMB. To validate that all issues and concerns are reviewed, the respective Service Secretariat, the Service Headquarters, appropriation/resource sponsors and BSOs are invited to attend the reclama review (DoN, April 1999).

Major Budget Issues (MBI) Meetings

The USD(C) is responsible for finalizing the PBD and submitting it to the Deputy, Secretary of Defense for signature. After the final decisions of the PBDs are distributed, meetings with the SECDEF and OMB and the respective Service Secretaries are conducted. These are known as the Major Budget Issues (MBI) meetings. The SECDEF and OMB meet with SECNAV along with the CNO and CMC to discuss the results of the signed PBDs. During the MBI meeting, the SECNAV, CNO, and CMC discuss their unresolved issues with the PBDs. If the issues addressed are not resolved during the MBI meeting, the unresolved issues remain pending until the SECDEF has his meeting with the President (DoN, April 1999).

SECDEF/OMB Meeting with the President

To finalize the budget, the SECDEF and the Director of OMB meet with the President. During this meeting, final presidential decisions regarding the budget and unresolved issues between the SECDEF and OMB are addressed. As a result of this meeting, end strength numbers, new inflation indices, any OMB issues that challenge a particular Defense program, and new Defense Budget totals are determined. Based on the outcome of this meeting, SECDEF issues new PBDs that reflect the President's decisions on the Defense budget. These PBDs are usually in December, while the majority of the other PBDs have been issued in October or November (DoD, April 1999).

President's Budget (PB)

In January, the SECDEF forwards the DoD's budget, as adjusted by PBDs, to OMB. In turn, OMB forwards the budget to the President for review and approval. The President reviews and approves or rejects the DoD's budget and ultimately incorporates it as part of the annual President's Budget (PB). Once the President has approved the PB, it is then forwarded to Congress for review and approval. At this stage of the PPBS process, the FYDP is updated for the third time. The PB is the final product of the budget phase and must be submitted to Congress no later than the first Monday in February (Naval Postgraduate School, 1999).

Congressional Review

Congress processes the PB through the Budget Committees, Authorization Committees, and Appropriation Committees for review and approval. Based on the decisions made by Congress on the PB, Appropriation Bills are produced and forwarded to the President for review and approval. Once the President signs the Appropriation Bills, they become law. The first of October marks the first day of the new fiscal year for the federal government and appropriations are distributed to the federal agencies and departments (Under Secretary of Defense (Comptroller), 1998).

Conclusion

The PPBS process is extremely complicated and requires the involvement of numerous individuals to produce the large number of required documents. The PPBS process is intended to ensure that the development of a defense strategy focuses on the potential national threats and that the plans to protect the nation's interest are within the fiscal constraints. Figure 5 illustrates the timeline of the PPBS.

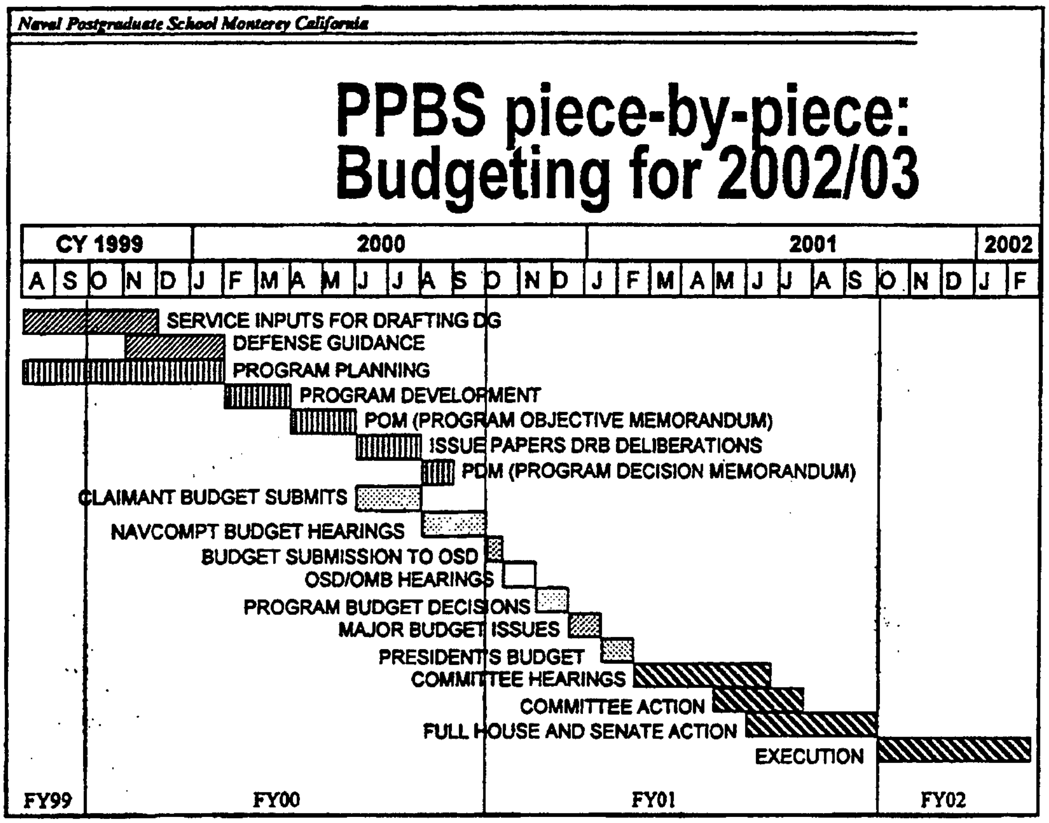


Figure 5 - The PPBS Timeline

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APPENDIX H. THE DON BUDGET FORMULATION PROCESS

Budget formulation in the Department of the Navy (DoN) is a dynamic process that involves people at all levels within the DoN. The purpose of the budget phase is to generate a federal budget document to be used for allocating resources based on the decisions of the President and Congress. In the PPBS appendix, the budget process was addressed on a macro level. This appendix will focus on the budget process at a more detailed level. The purpose of this appendix is twofold: to provide a summary of the key players and an overview of the DoN's budget formulation process. The explanation of the DoN's budget formulation process begins with a brief summary of the roles of each player/activity and their required contributions. Lastly, this appendix will provide the reader with a condensed version of what is involved in the DoN budget formulation process.

The sole purpose of developing a budget is to establish a financial plan and decision-making tool for managers to utilize (Office of Management and Budget, July 1999). The DoN views the budget as being a major management tool for planning and control. Moreover, the DoN's budget process is considered to be a disciplined approach to distributing resources after all programs and plans have been reviewed during the Planning, Programming, and Budgeting System process (Assistant Secretary of the Navy (Financial Management & Comptroller), 1995).

The DoN's Key Budget Formulation Players

The key players in the DoN budget formulation process are:

1. The Assistant Secretary of the Navy (Financial Management & Comptroller) (ASN(FM&C));

2. Director of the Office of Budget/Fiscal Management Division (FMB)/N-82;

3. Chief of Naval Operations (CNO);

4. Deputy Chief of Naval Operations (Resources, Warfare Requirements and Assessment) (N8);

5. Commandant of the Marine Corps (CMC);

6. The Marine Corps Programs and Resources (P&R) Department;

7. Assistant Secretary of the Navy for Research, Development, and Acquisition (RD&A)/Office of the Chief of Naval Research (OCNR); and

8. Budget Submitting Offices (BSO)/Major Claimants (DoN Office of Financial Management and Budget, April 1999).

The following sections will discuss each member/activity's roles and responsibilities in the DoN's budget formulation process.

Assistant Secretary of the Navy (Financial Management and Comptroller) (ASN(FM&C))

The ASN(FM&C), also known as the Comptroller of the Navy, is responsible for instituting the principles, polices, and procedures for preparing and administering the DoN's budget. Moreover, the ASN(FM&C) is required to provide guidance and direction for technical issues to all the DoN components involved in the budget formulation process. The guidance that the ASN(FM&C) produces is a compilation of all of the requirements from higher authorities. These include congressional directives, Office of Management and Budget (OMB) circulars, and guidance mandated by the Office of the Secretary of Defense (SECDEF) and the Office of the Secretary of the Navy (SECNAV). The technical direction issued by the ASN(FM&C) highlights the instructions documented in the budget call and necessary review and coordination requirements for all the DoN components (Under Secretary of Defense (Comptroller), 1998).

Director of the Office of Budget/Fiscal Management Division (FMB)/N-82

The Director of FMB reports to the Secretary of the Navy through the Comptroller of the Navy and is responsible for budget formulation, justification, and execution of the DoN budget. In addition, the Director of FMB is responsible for the principles, policies, and procedures for preparation and administration of the DoN budget. FMB is comprised of a congressional liaison office and four divisions. The following paragraphs will identify and summarize the role played by each division.

The Appropriations Matters Office (FMBE) acts as a liaison among the Congressional Appropriations Committees, the Office of Legislative Affairs, and the Congressional Liaison Offices of the Secretary of Defense, Secretary of the Army and Secretary of the Air Force for issues relating to congressional hearings. Some of the FMBE responsibilities include coordinating responses to committee questions, coordinating the review of transcripts of hearings, and arranging briefings for members of the committees and their staffs.

The Operations Division (FMB1) reviews, recommends, and revises estimates for the Military Personnel (Active and Reserve forces) and Operation & Maintenance (Active and Reserve) appropriations. FMB1 is also responsible for assisting the Office of the Secretary of Defense, OMB and Congress in justifying estimates and providing recommendations for adjusting allocations. In addition, FMB1 is responsible for publishing schedules of hearings, attending hearings, preparing and reviewing reclamas to

Program Budget Decisions (PBDs) and providing input for the Major Budget Issues (MBI) meetings.

The Investment and Development Division (FMB2) responsibilities include reviewing, recommending, and revising estimates for the Procurement, Research and Development, Construction, Family Housing, and Base Closure and Realignment appropriations.

The Program/Budget Coordinating Division (FMB3) responsibilities include the preparation of the DoN budget guidance and procedures; control and coordination of budget submissions; and coordination of reclamas to the Secretary of Defense's PBDs.

The Business and Civilian Resources Division (FMB4) responsibilities include reviewing, recommending, and revising estimates for the Navy Working Capital Fund and civilian personnel. FMB4 is also responsible for reviewing and validating funding estimates in working capital fund activity budgets to ensure proper balance between Navy Working Capital Fund "providers" and the DoN appropriated fund "customers" (DoN Office of Financial Management and Budget, April 1999). Figure 1 illustrates the FMB organizational structure (DoN Office of Financial Management and Budget, April 1999).

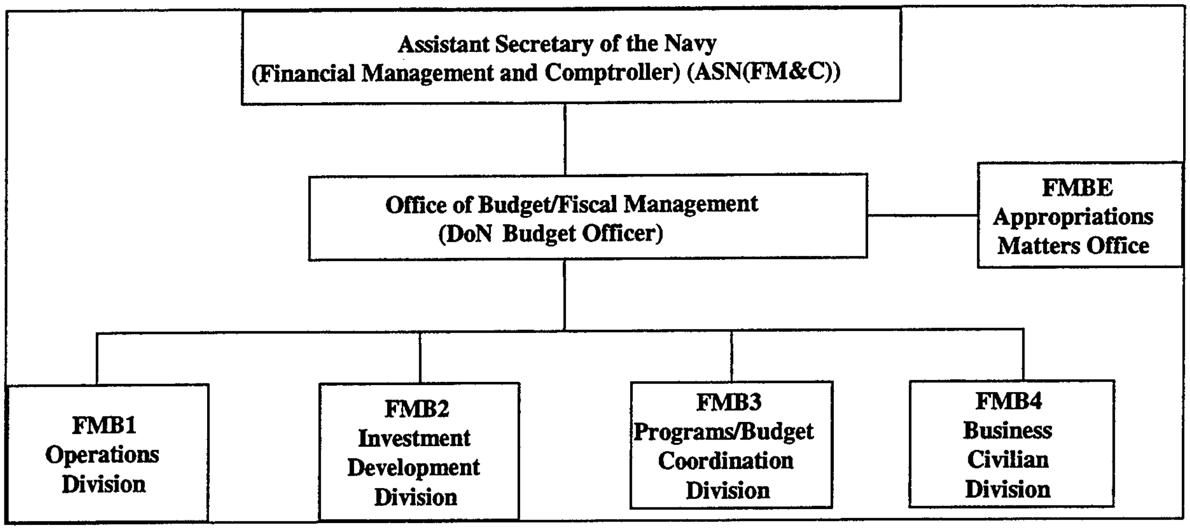

Figure 1 - FMB Organizational Structure

Chief of Naval Operations (CNO)

One of the CNO's major responsibilities in the budget formulation process is to generate a plan that prioritizes the utilization of naval resources to carry out the mission of the Navy. This plan includes the DoN's biennial budget and four additional outyears, and is an essential part of the programming phase of the PPBS. The CNO's plan is eventually incorporated into the DoD's Future Years Defense Program (FYDP). One example of the types of resources included in the CNO's plan is the material support needs of the Operating Forces of the Navy. Other examples are aircraft operating costs for Fleet Marine Force Units and personnel, and the funding for Reserve personnel. The CNO is also responsible for overseeing the POM development along with the Director of the Fiscal Management Division (N82)

(Office of the Assistant Secretary of the Navy (Financial Management & Comptroller), October 1998).

Deputy Chief of Naval Operations (Resources, Warfare Requirements and Assessment) (N8)

N8 is responsible for integrating the DoN's planning, programming, and budgeting process, as well as the execution of the budget for the CNO. N8 is also responsible for representing the CNO in resolving Navy budget issues. Within N8 there are three divisions that play a significant role in the budget formulation. The following paragraphs will identify the divisions and summarize their responsibilities.

The Programming Division (N80) is responsible for the programming process for the CNO. During the budget formulation, N80 assists FMB in translating the Navy POM and Program Decision Memoranda (PDMs) from program terms to budget terms. Within N80, the Congressional Policy and Coordination Branch (N804) is the subdivision that is responsible for coordinating all congressional matters for the CNO. N804 also serves as the coordinator for the Office of Legislative Affairs and FMBE concerning congressional issues (DoN Office of Financial Management and Budget, April 1999).

The Assessment Division (N81) assesses each of the five warfare areas and the seven support areas of the Integrated Warfare Architecture (IWAR) structure. The twelve IWARs are analyzed, and the results of these assessments are published in the CNO Program Analysis Memoranda (CPAMs). As previously mentioned in the PPBS appendix, the twelve CPAMs are consolidated into an integrated program to ensure that the programs are balanced across the IWAR structure. These programs must be within the acceptable fiscal limits of the Navy Total Obligation Authority (TOA). The CPAMs are the foundation for the Navy's Programming Guidance which outlines the impact on warfare capabilities in the short and long-term (Zimmer, 1997).

The Fiscal Management Division (N82) is an integral part of FMB and serves as the Responsible Office for the fiscal management of Navy appropriations, with the exception of Research, Development, Test and Evaluation, Navy (RDT&EN) appropriation (see discussion below). N82 reviews budget estimates to ensure they correspond with the POM. N82 has a "dual-hatted" role, reporting to the CNO and to the Assistant Secretary of the Navy (FM&C) as the Director of the Office of Budget (FMB) (DoN Office of Financial Management and Budget, April 1999).

Commandant of the Marine Corps (CMC)

The CMC is responsible for ensuring the efficient use of resources for Marine Corps operations. Like the CNO, the CMC is required to develop a plan to determine the financial and personnel requirements needed to successfully carry out the mission of the Marine Corps (DoN Office of Financial Management and Budget, April 1999).

The Marine Corps Programs & Resources (P&R) Department

The Programs & Resources (P&R) Department is the Responsible Office for the Marine Corps. P&R responsibilities are similar to N82's in that P&R is the fiscal manager and also the Responsible Office for all Marine Corps appropriations (DoN Office of Financial Management and Budget, April 1999).

Assistant Secretary of the Navy for Research, Development and Acquisition (RD&A)/Office of the Chief of Naval Research (OCNR)

The Assistant Secretary of the Navy (RD&A)/Office of the Chief of Naval Research (OCNR) is the Responsible Office for the management of the RDT&EN appropriation. The Chief of Naval Research assists the Assistant Secretary of the Navy (RD&A) requirements at the RDT&EN appropriation level with coordinating and compiling the budget, accounting, and reporting (Assistant Secretary of the Navy (Financial Management & Comptroller), 1995).

Budget Submitting Offices (BSOs)/Major Claimants

BSOs/Major Claimants are responsible for producing the budget estimate submissions (BES) and the submission of these estimates in the appropriate budget exhibits to the Responsible Offices. In addition, the BSOs are accountable for ensuring that subordinate commands submit budget inputs in a timely manner. Figure 2 lists the DoN Budget Submitting Offices (BSOs)/Major Claimants (DoN Office of Financial Management and Budget, April 1999).

Director, Field Support Activity*
Assistant for Administration, Office of the Under Secretary of the Navy (AAUSN)*
Chief of Naval Research (OCNR)
Director, Office of Naval Intelligence (ONI)*
Chief, Bureau of Medicine and Surgery (BUMED)*
Commander, Naval Air Systems Command (NAVAIR)*
Bureau of Naval Personnel (BUPERS)*
Naval Supply Systems Command (NAVSUP)*
Commander, Naval Sea Systems Command (NAVSEA)*
Commander, Naval Facilities Engineering Command (NAVFAC)*
Headquarters, United States Marine Corps (HQMC)*
Director, Strategic Systems Programs (SSP)*
Commander, Space and Naval Warfare Systems Command (SPAWAR)*
Director, Naval Systems Management Activity (NSMA)*
Commander-in-Chief U. S. Atlantic Fleet (CINCLANTFLT)*
Commander-in-Chief U. S. Naval Forces, Europe (CINCUSNAVEUR)*
Chief of Naval Education and Training (CNET)*
Commander, Naval Computer and Telecommunications Command

(COMNAVCOMTELCOM)*
Commander, Naval Meteorology and Oceanography Command (COMNAVMETOCCOM)*
Naval Security Group Command Headquarters (NAVSECGRU)*
Commander-in-Chief U.S. Pacific Fleet (CINCPACFLT)*
Commander, Naval Reserve Force (COMNAVRESFOR)*
Naval Special Warfare Command (NAVSPECWARCOM)

Figure 2 - DoN Budget Submitting Offices (BSOs)
*** Major Claimants**

The Purpose of Responsible Offices

Responsible Offices are responsible for the fiscal management of all programs financed by an appropriation or fund. One of the Responsible Office's major fiscal responsibilities consists of integrating programming and budgeting actions by coordinating budget estimate reviews with headquarters staff to ensure programmatic decisions conform with the approved POMs. Other responsibilities include providing fiscal control of funds that have been allocated by FMB, reviewing the execution of allocated funds to ensure that program objectives are satisfied and identifying the need to reprogram funds (Office of Budget/Fiscal Management Division, 1999). Figure 3 illustrates the respective Responsible Offices and the corresponding appropriations (DoN Office of Financial Management and Budget, April 1999).

Appropriation	Responsible Office
Military Personnel, Navy (MPN)	CNO (N82)
Military Personnel, Marine Corps (MPMC)	CMC (P&R)
Reserve Personnel, Navy (RPN)	CNO (N82)
Reserve Personnel, Marine Corps (RPMC)	CMC (P&R)
Operation and Maintenance, Navy (O&MN)	CNO (N82)
Operation and Maintenance, Marine Corps (O&MMC)	CMC (P&R)
Operation and Maintenance, Navy Reserve (O&M,NR)	CNO (N82)
Operation and Maintenance, Marine Corps Reserve (O&MMCR)	CMC (P&R)
Environmental Restoration, Navy (ERN)	CNO (N82)
Aircraft Procurement, Navy (APN)	CNO (N82)
Weapons Procurement, Navy (WPN)	CNO (N82)
Shipbuilding and Conversion, Navy (SCN)	CNO (N82)
Other Procurement, Navy (OPN)	CNO (N82)
Procurement, Marine Corps (PMC)	CMC (P&R)
Research, Development, Test and Evaluation, Navy (RDT&EN)	CNR (OCNR)
Military Construction, Navy (MCN)	CNO (N82)
Military Construction, Navy Reserve (MCNR)	CNO (N82)
Family Housing, Navy and Marine Corps (FHN&MC)	CNO (N82)
Base Realignment and Closure (BRAC)	CNO (N82)
Navy Working Capital Fund (NWCF)	CNO (N82)
National Defense Sealift Fund (NDSF)	CNO (N82)
Procurement of Ammo, Navy and Marine Corps (PANMC)	CNO (N82)

Figure 3 – Major DoN Appropriations and Responsible Offices

The DoN's Budget Formulation Process

Numerous OMB, DoD and DoN directives and budget guidance regulate the DoN's budget formulation process. One important directive published by OMB is *Circular No. A-11: Preparing and Submitting Budget Estimates,* which outlines the stages of budget formulation in preparing and submitting budget estimates. *OMB Circular No. A-11* requires that estimates reflect actual obligation data for the prior year and planned obligations for the current and budget year. In addition, *OMB Circular No. A-11* mandates that full costs be specified for all appropriations to ensure proper pricing of budget estimates. *OMB Circular No. A-11* also serves as a guide for developing the requirements that are particular to the current BES (Office of Management and Budget, July 1999).

The Office of the Assistant Secretary of Defense (Comptroller) publishes additional budget guidance, titled *DoD Financial Management Regulations* (FMR). The FMR provides general guidance on the formulation and submission of the budget estimates to the Office of the Secretary of Defense. At the DoN level, the Office of the ASN (FM&C) provides its budget guidance, titled the *Budget Guidance Manual*. The *Budget Guidance Manual* is the main source of information on budget formulation and presentation of the Department of the Navy Budget. In addition to the budget guidance mentioned above, FMB publishes budget guidance memoranda at various times during the budget process. These memoranda provide supplementary guidance for specific events within the phases of the budget process. After the annual guidance from higher authority (i.e., the budget call) has been issued, the initial budget preparation begins at the field activities. The following paragraphs will outline the flow of the budget formulation process.

The DoN Budget Call

The DoN budget call released from ASN(FM&C) initiates the annual budget formulation process. Figure 4 illustrates a DoN budget call flow involving the Naval Postgraduate School chain of command. This information was acquired through an interview with Ms. Megan Reilly, Comptroller at the Naval Postgraduate School on 05 December 1999.

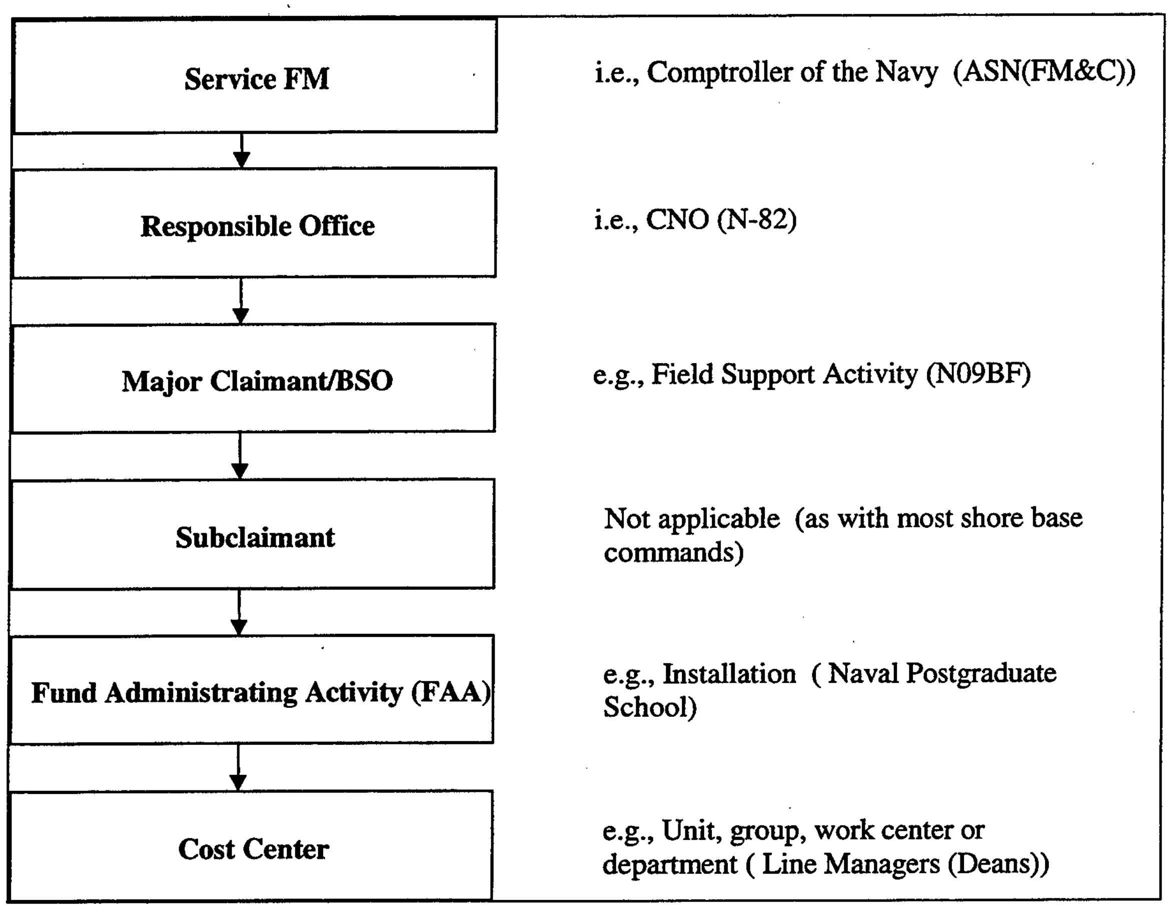

Figure 4 - Budget Call Flow Chart

ASN(FM&C), via FMB, issues the budget call to its various Responsible Offices. The budget call provides budget guidance and budget controls to the Major Claimants/BSOs and is used to generate funding inputs for the various appropriations. The guidance specified in the budget call includes inflation indices and changes in the procedures for preparing budget exhibits. The budget controls set the level of funding available to be budgeted by appropriation, based on the current President's Budget.

Additionally, the budget calls may also stipulate extra restrictions known as fences, ceilings and floors. Fences are explict limitations on the use of funds as provided by Congress in the appropriations act. A ceiling is a maximum amount of an appropriation imposed by Congress which is designated for a specific purpose (e.g., travel funding). A floor is a minimum amount of an appropriation imposed by Congress designated for a specific purpose (e.g., maintenance of real property) (Office of the Assistant Secretary of the Navy (Financial Management & Comptroller), October 1998).

The Responsible Offices pass down budget calls to the Major Claimants/BSOs, who provide budget inputs for one or more appropriations. Major claimants will therefore require budget inputs from subclaimants, who are generally a Type

Commander, bureau, office, or command designated under a major claimant. Type Commanders (e.g., Commander U.S. Surface Forces Atlantic (COMNAVSURFLANT)) normally have cognizance over Fleet Units. Shore-based naval commands generally do not have a Type Commander within their chain of command. In such cases, Major Claimants will request the budget inputs directly from the Fund Adminstrating Activity (FAA).

The FAA is subordinate to the Subclaimant or Major Claimant and is responsible for the management of resources. The FAAs coordinate with the Cost Centers, scrutinizing all budget guidance in preparation for the development of budget inputs. The FAAs collect data from the Cost Centers based on the current President's Budget controls and update all the programs of which the budget is comprised. The final phase of the budget call is when the budget guidance is passed to the Cost Centers. The Cost Center is a unit, group, work-center or department which works to achieve identification of costs at the lowest level (DoN, Office of the Comptroller, July 1993).

As an example, the Naval Postgraduate School Comptroller receives the budget call from Field Support Activity (Code N09BF) delineating specific budget exhibit guidance, budget controls and inflation indices. The

Comptroller then coordinates with the Cost Centers under her cognizance to delineate the controls that have issued.

Budget Estimate Submissions

Ultimately, all funding inputs are rolled back up to the FMB in the form of Budget Estimate Submissions (BES) which are compiled to produce an overall DoN budget. This section will provide an overview of the BES development process as shown in Figure 5, which illustrates a DoN Budget Estimate Submission (BES) flow involving the Naval Postgraduate School chain of command.

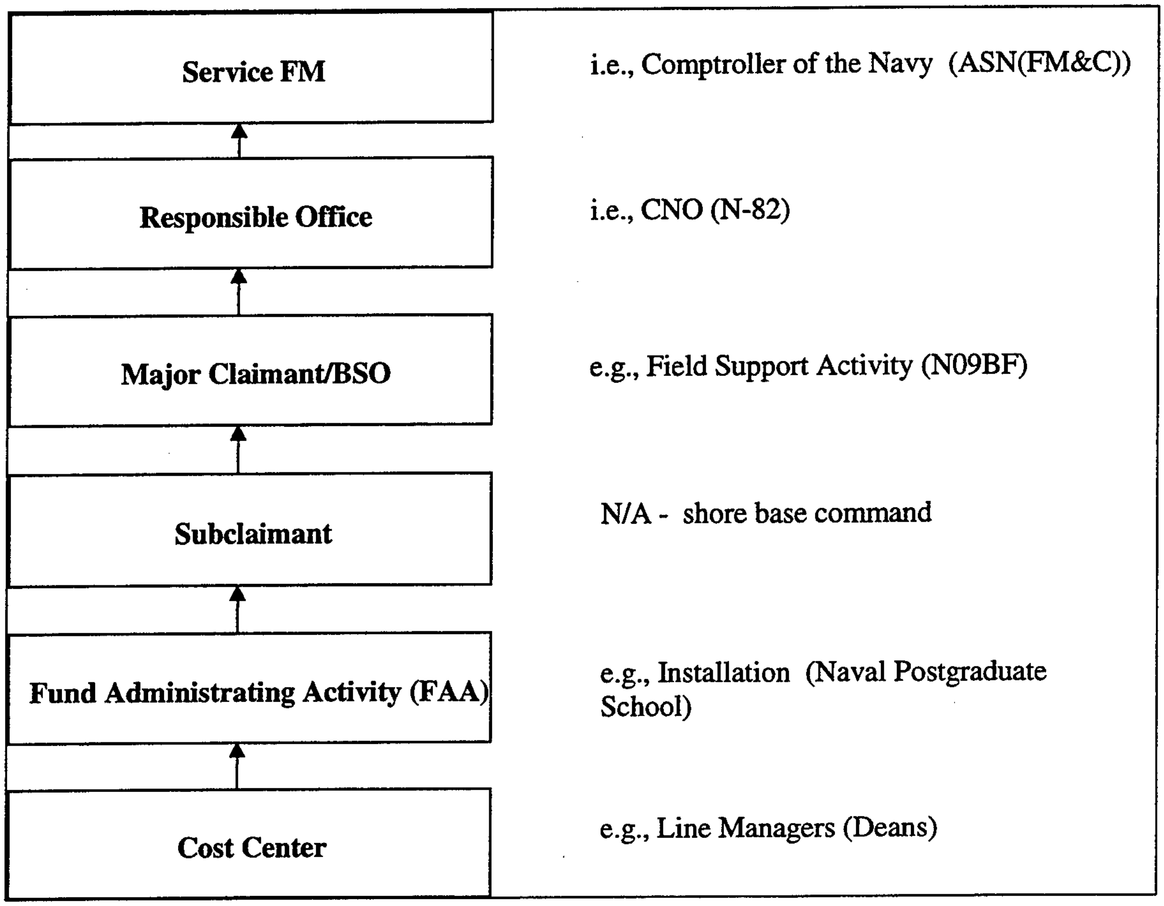

Figure 5 - BES Flow Chart

The formulation of the BES begins at the level of the Cost Centers and is forwarded to the Fund Administrating Activity (FAA), the NPS Comptroller. The FAA budget inputs are submitted to the assigned Subclaimant, or in this example, directly to the BSO, CNO N09BF. The Major Claimants/BSOs such as CNO N09BF are responsible for generating the BES for submission to FMB.

Continuing from the above budget call example for the Naval Postgraduate School, once the Comptroller coordinates with the Cost Centers, the Cost Centers then review their historical budget data and current budget data to determine their budget inputs. The Cost Centers forward their budget inputs to the Comptroller for review and adjustments. The Comptroller reviews the budget inputs to ensure the budget estimates are within the budget controls. In the Budget Exhibit section of this thesis, this process will be described in detail.

Appropriation Structure

Because the budget estimates are submitted by appropriation, it is appropriate to discuss the appropriation structure. The major DoN appropriations shown in Figure 3 are actually a compilation of cost categories. The cost categories provide the accounting structure for the appropriations. This structure is intended to facilitate the tracking and accountability of each appropriation. Figure 6 illustrates the O&M appropriation accounting structure for the Naval Postgraduate School.

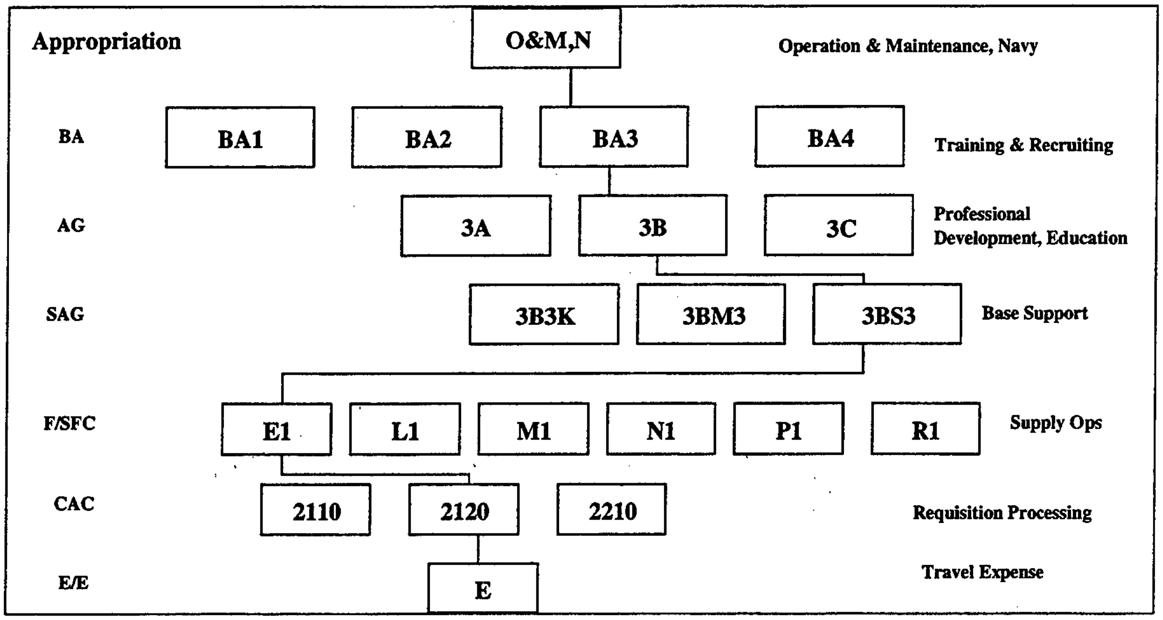

Figure 6 – An O&M Appropriation Accounting Structure Example

The first division of the appropriation is the Budget Activity (BA). BAs are used to classify the specific functions contained in the budget. The second cost category specific to the O&M appropriation is the Activity Group (AG) which is composed of Subactivity Groups (SAG). AG/SAGs are codes that designate the utilization of funds in the budget (Office of the Comptroller, July 1993). The SAGs are further divided into Functional/Subfunctional Categories (F/SFC) which specify the function for which the funds are utilized.

Lastly, the F/SFC are subdivided into Cost Accounting Codes (CAC) and Expense Elements (EE). The CAC describes the F/SFC in greater detail and finally the EEs break down the type of expense. CACs and EEs are the building blocks for the functional category reports (e.g., OP-5 and OP-32). The EEs identify the estimates for the programs and projects within a particular SAG. The EEs are the basic building blocks of the budget beginning at the Cost Center level.

The F/SFC, CAC, and EEs, codes, used in the budget formulation process to provide historical data in order to generate budget estimates, are also used during the budget execution process (DoN, Office of the Comptroller, July 1993). For example, when Cost Centers are generating their budget inputs, they must take into consideration historical costs and current execution costs. An example of some of the costs are those associated with civilian personnel and utilities.

As mentioned previously, the AG division is specific to the O&M appropriation. The appropriations listed in Figure 7 are also subdivided, but these divisions have different labels to reflect different purposes. Figure 7 illustrates the equivalents to activity groups in these appropriations (Under Secretary of Defense (Comptroller), June 1998). Therefore, budget estimates are prepared down to the activity group equivalent for the appropriations, as applicable.

Appropriations	Activity Group (AG) Equivalent
RDT&E	Program Elements
MCN	Projects
Procurement	Budget Line Items
MILPERS	Subactivities

Figure 7 - Appropriation with AG Equivalent

All budget materials required from BSOs for appropriations must be submitted electronically via the Justification Management System (JMS), by automated submission to the Navy Budget Tracking System (NBTS) or the Budgetary Object Classification System (BOCS) (DoN Office of Financial Management and Budget, April 1999).

Types of Costs

The data that are incorporated into the BES are updated obligation estimates such as costs (e.g., labor, material, supplies, training, etc.) for all programs within a particular SAG. These costs can be categorized as fixed, variable or semi-variable. Fixed costs remain constant and are not dependent on the level of activity or volume of output. An example of a fixed cost is the cost of ground maintenance. Variable costs are costs that are dependent on the level of activity or volume of output. An example of a variable cost is the number of reams of paper used in a printer. Semi-variable costs, like variable costs, would be calculated as a percentage of a volume of output up to a threshold and then would transition to a constant cost. An example of a semi-variable cost is payroll tax (Joint Industry/Government, Spring 1999).

Costs can also be categorized as either discretionary or non-discretionary. Discretionary means to the degree in which costs can be influenced such as travel, training, and facility upgrades (e.g., installing new carpet or painting a room). Non-discretionary costs, like fixed costs, are set and remain relatively stable during budget execution. Examples of non-discretionary costs are costs associated with civilian personnel (e.g., salaries and health benefits) and utilities. At the Naval Postgraduate School, a substantial portion of the O&M budget is non-discretionary. According to the Naval Postgraduate School 1999 fiscal year budget, 69 percent of the budget was for civilian labor, with 3 percent earmarked for utilities and 18 percent for service contracts. This leaves only 10 percent of the total budget as discretionary. This 10 percent includes the funds available for supplies and materials in each Cost Center.

Budget Exhibits

Budget exhibits are the foundation of the budget estimate submission. Budget exhibits provide obligation estimates and additional budget estimate information required by higher authority. There are numerous budget exhibits that provide supporting budget estimates and data, such as the OP-14 (Summary of Service-Wide Training and Education) and OP-53 (Overseas Funding).

The Operation & Maintenance (O&M) appropriation is the most widely used and provides commands with the budget authority needed to carry on day-to-day operations. It includes funding for civilian personnel, temporary additional duty (TAD) travel, maintenance of real property, utilities, materials and supplies, etc. Operation and Maintenance, Navy (O&MN) is the appropriation discussed in this section. The OP-32 (Summary of Price and Program Growth) and the OP-5 (Detail by Activity Group) provide financial information for each budget activity. Additionally, the OM-6 (Unfunded Requirements) is discussed.

The OP-32 Exhibit

The OP-32 exhibit is one of the primary exhibits for the O&M budget and is a summary of price and program growth within a SAG. It spells out how the activity is planning to spend its budgetary funds by the type of purchase. It will be submitted for all Subactivity Groups relevant to the activity. The sum totals of the OP-32 exhibits are not to exceed the assigned budget control numbers. Also, this exhibit must match the OP-5 exhibit regarding the pricing and program adjustments between the current year and budget years (Field Support Activity, March 1998). This exhibit tracks prior year program totals to current year totals, including price and program growth, to budget year one and budget year two totals, including price and program growth. Inflation factors are provided by object class in the budget call letter for the pricing column (DoN Office of Financial Management and Budget, April 1999).

The OP-32 provides detailed price and program changes by object class. An object class represents types of services, articles, or other items for which costs are incurred in carrying out a budgeted program (Office of the Comptroller, July 1993). Cost Centers provide their budget inputs on their respective programs at a detailed level that defines the labor, contracts, travel and supply costs. These costs can be tracked based on actual program execution because the accounting system collects job order expenditures at the EE, CAC, F/SFC levels.

At NPS, program managers are given budget controls from the Comptroller that match the budget guidance letter. For example, the MWR program director who is budgeting for labor costs can check the labor EE against the job order number or subfunctional code to ensure that the data are accurate (DoN Office of Financial Management and Budget, April 1999).

Any aspect of the program that is above the budget controls is annotated on the OM-6 Unfunded Requirements form. This will be further discussed in the OM-6 Unfunded Requirements section.

The OP-5 Exhibit

The OP-5 exhibit provides a summary and justification for changes in the level of resources required for each SAG. The OP-5 exhibits are submitted by SAGs that reflect the funded programs (Field Support Activity, March 1998). According to Ms. Megan Reilly,

> The OP-5 gives the dollar track and narrative description, beginning with changes from the President's CY estimate to the current CY submission and then tracking from year to year….the OP-5 tells a story. This exhibit balances to the bottom line OP-32 according to SAG, and describes what is happening year to year due to inflation, program increases and/or program decreases. It is essential that you understand what is happening in all of your programs for you to do this exhibit….refer to previous OP-5's as your baseline for programmatic changes that were submitted….stay consistent to this story and add any new programs adjustments that have occurred since that last

submission....this is usually the most challenging exhibit to do.

The OP-32 can be a tool in completing this exhibit by showing the net changes within a SAG. The OP-32 has a column for programmatic changes according to object class but the number in this column represents the net effects of changes in various programs (i.e., thus a 0 in the programmatic column does not necessarily mean that there is no programmatic change....it may represent one program's increase and another program's decrease that just happens to net to 0)....thus you will know the net balance of all programmatic changes but the OP-5 must break out these changes by specific programs, not object class, and the OP-5 must show detailed information, not the net information....You must be familiar with your programs!

The six segments of the OP-5 are discussed within this section. The first segment in this exhibit is the Description of Operations Financed. This segment describes the nature of each item funded in the SAG.

The second segment in this exhibit is the Financial Summary. This segment lists the SAGs, and these figures should match with the fiscal totals of the OP-32 exhibit.

The third segment in the OP-5 is the Performance Criteria and Evaluation. Within the Performance Criteria and Evaluation segment, meaningful performance and work load data is provided.

The fourth segment is the Personnel Summary section. This segment provides military and civilian personnel end strength, and military and civilian work years data.

The fifth segment is the O&M Outyear Impact Summary, for which the data are provided by the claimant.

Lastly, the Reconciliation of Budget to Current Estimate section is the sixth segment. This segment is the narrative explanation reconciling changes from the updated estimates of the current fiscal year with the amount previously presented to Congress (Field Support Activity, March 1998).

The OM-6 Unfunded Requirements

Unfunded requirements are mission needs that are above and beyond the control numbers provided by higher authority. These are usually items that could not be added within the controls because of pricing changes and adjustments which occurred since the approval of the program. The OM-6 summarizes programs in a prioritized listing and details justification for each unfunded mission need. Other deficiencies noted on the unfunded requirements would include program decreases from the approved programs and emergent, critical unfunded requirements. Unfunded requirements are submitted with the OP-32 and OP-5, and during the mid-year review of the execution year (Field Support Activity, March 1998).

Conclusion

This appendix reviewed the process used to develop the DoN budget. The budget estimates are formulated and submitted by appropriation through each phase of the process. The DoN's flow for budget preparation is a top-down directed and bottom-up formulation process that involves OMB, SECDEF, CNO, Comptroller of the Navy, Responsible Offices, BSOs/Major Claimants, Subclaimants, Fund Administrating Activities, and Cost Centers. The responsibilities of each major participant within the DoN budget formulation process were summarized in this appendix.

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APPENDIX I. BUDGET EXECUTION

This appendix is intended to provide the reader with a summary of how funds are distributed and executed within the Department of the Navy (DoN). It will also address legal considerations relating to the execution of funds. Effective budget execution results from complying with laws, regulations and guidelines mandated by Congress, the U.S. Treasury, the General Accounting Office (GAO), the Office of Management and Budget (OMB), the SECDEF, and all DoN echelons with command authority (Under Secretary of Defense (Comptroller), 1996).

The process by which appropriations are distributed begins with the Congress. The conditions delineated in the Congressional Budget and Impoundment Control Act of 1974 require Congress to pass the DoD Appropriations Act by 1 October. Each DoD Appropriations Act outlines the specific dollar limits that the DoN can use for obligations against the budgeted programs. In the event that Congress does not pass the DoD Appropriations Act by 1 October, the enactment of a Continuing Resolution Authority (CRA) is required. The CRA provides the necessary funds to maintain the operations of federal agencies until regular appropriations can be approved. The CRA provides budget authority in the form of a rate of spending, vice an amount.

The DoN Program Budget Accounting System (PBAS)

On 1 October 1998, the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) implemented the DoN Program Budget Accounting System (PBAS). The DoN PBAS is used as a multi-level electronic funds control and distribution system. This system allows users to access funding allocations through their personal computers. The funding allocation begins at Level 1, the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), and is then distributed to Level 2, Headquarters. Level 2 consists of the Chief of Naval Operations (CNO), the Commandant of the Marine Corps (CMC), the Office of Naval Research (ONR), and the Assistant for Administration, Office of the Under Secretary of the Navy (AAUSN). All DoN appropriations are distributed through the DoN PBAS. The DoN PBAS interfaces with the Navy's Standard Accounting and Reporting System (STARS) to generate reports such as the Standard Form 133 (Report on Budget Execution) (Gormely, 1999a).

As stated by Mr. Kevin E. Gormely, head of Department Funds Control in the Office of Financial Operations, Office of the Assistant Secretary of the Navy (Financial Management and Comptroller),

> As the new millennium begins, Navy financial managers move to a world where electronic fund authorization documents are sent directly to their personal computer. This innovation is the result of two Department initiatives. The first initiative is to create Chief Financial Officer (CFO) Act compliant financial systems and improve financial management and accountability. The second initiative is to move to a paperless environment made possible through instant telecommunications. The days of typing fund authorizations, manually signing documents, mailing copies, and waiting for faxes will soon be history. Immediately after approval, fund authorization can be available worldwide (Gormely, 1999b).

The PBAS funds control system allows departmental level appropriation controls to be entered, including the Treasury warrants, OMB apportionments, quarterly apportionments for the operations and maintenance and military pay appropriations, appropriation transfers, recissions (i.e., a legislative action that cancels budget authority) and major reprogramming. After all the controls have been entered into the DoN PBAS, official fund authorization documents for the Navy are issued. The funds control process is intended to record transactions of funds used, and act as an indicator to ensure budgetary limits are not exceeded.

This excerpt from Mr. Gormely's article highlights how funds are distributed to Navy commands by PBAS.

> DoN PBAS will produce for Navy commands a separate SECNAV Form 7131/1 official fund authorization document (FAD) for each appropriation received. Section A, Direct Program, on the FAD will indicate program

amounts by budget authority, procurement P-1 line item, or program element, depending on the appropriation. Section B, Budget Authority, provides one total budget authority line. Each document will contain a remarks section for guidance, or remarks passed by higher headquarters. A footnote section will contain standard footnotes that apply to the appropriation. A 'reason' code for each line will explain the reason for this FAD change, such as a 'below threshold reprogramming,' an 'undistributed Congressional reduction,' or 'funds released from 'withhold' status' (Gormely, 3rd Quarter FY1999).

The DoN PBAS is an on-line funds management system that allows the user to access and track (commitments and obligations) for their appropriations at any given time. In addition, PBAS provides the user with real time recording of funding transactions information. This will help ensure that the agency is not obligating or disbursing funds above the appropriated and/or authorized amount. The DoN PBAS is intended to expedite funds distribution to commands, activities and organizations so that they can be more responsive in meeting mission requirements (Gormely, 3rd Quarter FY1999).

Budget Terminology

Key budget terms are defined so financial managers may increase their knowledge in budget execution.

1. Commitment is the administrative reservation of funds for a future obligation.

2. Obligation is the legal reservation of funds for future payment for material or services.
3. Expenditure is the actual payment or disbursement of funds issued by a voucher, claim, or government check issued by the U.S. Treasury.
4. Liquidation is the process by which payments are matched against existing obligations (Office of the Assistant Secretary of the Navy Financial Management & Comptroller, October 1998).

The following budget terminology pertains to the timing of an appropriation.

1. Regular - Appropriations that are issued at the beginning of the new fiscal year (i.e., 1 October). A total of 13 appropriations should be passed by Congress before the start of the new fiscal year (DoN, Office of the Assistant Secretary of the Navy Financial Management & Comptroller, October 1998).
2. Supplemental - Appropriations that are issued during the fiscal year to provide additional funding (Office of the Assistant Secretary of the Navy Financial Management & Comptroller, October 1998).
3. Deficiency - appropriations to permit payment to expired accounts to cover obligations incurred in

excess of available budget authority (GAO Thesaurus, No date).

Reprogramming and Transfer Authority

The budget terminology that refers to the transfer of funds within an appropriation is called reprogramming. In contrast, the transfer of funds between appropriations is called transfer authority.

Reprogramming refers to the utilization of funds in an appropriation account for purposes other than those considered at the time of appropriation. Reprogramming of funds above congressional thresholds must be accomplished by the approval of the appropriate congressional committees. Reprogramming of funds below congressional thresholds is implemented by a DoD Component (e.g., DoN) (Under Secretary of Defense (Comptroller), 1996).

Transfer authority is the authorization to move funds between appropriations. The DoD must first obtain approval from the Office of Management and Budget (OMB) to execute transfer authority. The transfer authority stipulates the dollar limits that the DoD cannot exceed in the funds transfer. The SECDEF is responsible for notifying Congress of all transfers of funds (Office of Management and Budget, 1997).

Types of Appropriations

There are several types of appropriations. Based on the type of appropriation (e.g., annual, multiple-year, no-year or continuing), the timeline of the obligation will vary. An annual appropriation provides federal agencies budget authority to incur obligations for a specified fiscal year, expiring at the end of that period (e.g., 1 October through 30 September). Generally, annual appropriations are apportioned on a quarterly basis. Multiple-year appropriations provide federal agencies the ability to incur obligations for a specific period of time in excess of one fiscal year. Typically, multiple-year appropriations are apportioned on an annual basis. A no-year appropriation provides federal agencies an indefinite period of time to incur obligations.

The purpose of setting specific timelines for appropriation distributions is to control the rate of obligation and expenditures. Multiple-year appropriations may have obligation periods from two to five years, while no-year or continuing appropriations are not subjected to a definite timeline (Under Secretary of Defense (Comptroller), 1996).

Based on the type of appropriation, the obligation and expenditure rates will vary. The obligation and expenditure rates are computed as a percentage of funds authorized. The Department of Defense (Comptroller) issues goals by appropriation. For example, the Military Personnel, Navy appropriation (MPN) obligation goal is 96 percent in the budget year, compared to the Shipbuilding and Conversion, Navy appropriation (SCN), whose obligation goal is 5 percent in the budget year. Hence, annual appropriations have a faster outlay (expenditure) rate than multiple-year appropriations.

During the budget execution phase, specific fund controls have been established to minimize the possibilities of over-obligation and over-expenditure. The various accounting and reporting systems used by the DoN are the tools to control funds and monitor expenditures.

Obligations that have been incurred during the obligation period of an appropriation result in expenditures or outlays. Based on the type of appropriation, funds may be obligated in the year of the expenditure or over several fiscal years. Expenditures are the actual payments of funds from the U.S. Treasury (Office of Management and Budget, July 1999). The source used to generate the chart below was the Defense Finance and Accounting Service *Accounting Classifications Manual.* The Figure 1 illustrates the obligation period for each major DoN appropriation (DFAS, May 1999d).

Appropriation	Obligation Period
Military Personnel, Navy (MPN)	1 Year
Military Personnel, Marine Corps (MPMC)	1 Year
Reserve Personnel, Navy (RPN)	1 Year
Reserve Personnel, Marine Corps (RPMC)	1 Year
Operation and Maintenance, Navy (O&MN)	1 Year
Operation and Maintenance, Marine Corps (O&PMC)	1 Year
Operation and Maintenance, Reserve Navy (O&MNR)	1 Year
Operation and Maintenance, Marine Corps Reserve (OMMCR)	1 Year
Research, Development, Test and Evaluation, Navy (RDT&E,N)	2 Years
Aircraft Procurement, Navy (APN)	3 Years
Weapons Procurement, Navy (WPN)	3 Years
Other Procurement, Navy (OPN)	3 Years
Procurement, Marine Corps (PMC)	3 Years
Shipbuilding and Conversion, Navy (SCN)	5 Years
Military Construction, Navy (MCN)	5 Years
Military Construction, Navy Reserve (MCNR)	5 Years
Family Housing Navy & Marine Corps (FH, N&MC)	5 Years
National Defense Sealift Fund (NDSF)	No Year

Figure 1 - Obligation Period Chart

Distribution of Funds

The sections describe the flow of funds through the various components in sequential order. This process is intended as a means of funds control established by Congress. As previously mentioned, Congress sets specific limits for obligations and expenditures.

After the President signs the appropriation bills, they become law. These appropriations are then forwarded to the Treasury Department which, in turn, issues Appropriation Warrants to the Office of Management and Budget (OMB). Appropriation Warrants specify the exact dollar amount to be used on a specific appropriation. Once OMB receives the Appropriation Warrants, they apportion the appropriations to the Federal agencies (e.g., the DoD) (Under Secretary of Defense (Comptroller), 1996).

Appropriations are issued annually and detail the specific amount of funds to be spent on a particular program, project or activity. Appropriations have three limitations: a specified dollar amount to be spent, a specific purpose for the funds, and an obligation period specifying the amount of time the funds can be used.

Apportionment controls the rate at which the Services can obligate funds. Apportionment is established by the Office of Management Budget (OMB), which distributes the appropriations to the federal agencies.

Allocation is a distribution of funds within the Service component (e.g., DoN). The Navy Comptroller is the designated official responsible for distributing the funds internally. At this level, funds are distributed within the DoN in accordance with congressional intent.

Suballocation is a further subdivision of the allocation of funds. Suballocation is the transfer of the overall administrative responsibility of fund execution to a specific program. Suballocation responsibility is generally given to the head of an office, bureau, or command.

Allotments and operating budgets are both subdivisions of appropriations. At this level, an official is given obligation authority to accomplish a specific function or mission. The operating budget is primarily used for the Operation & Maintenance (O&M) appropriation.

An allowance/OPTAR (Operating Target) is a subdivision of an allotment or operating budget. Allowances are administrative limits issued to cost centers within a command. Allowances are for internal budget tracking and do not provide budget authority and are not subject to 31 USC Section 1517 violations (Office of the Assistant Secretary of the Navy Financial Management & Comptroller, October 1998).

The O&M appropriation is the most widely used and provides installations with the budget authority needed to carry on day-to-day operations. It includes funding for civilian personnel, temporary additional duty (TAD) travel, maintenance of real property, utilities, materials and supplies, etc. Operations and Maintenance, Navy (O&MN) will be the appropriation example used to illustrate the flow of funds in Figure 2 (Naval Postgraduate School, 1999). The figure below is intended to provide the reader with a general concept of how budget authority is passed down from Congress through the various levels of the DoN.

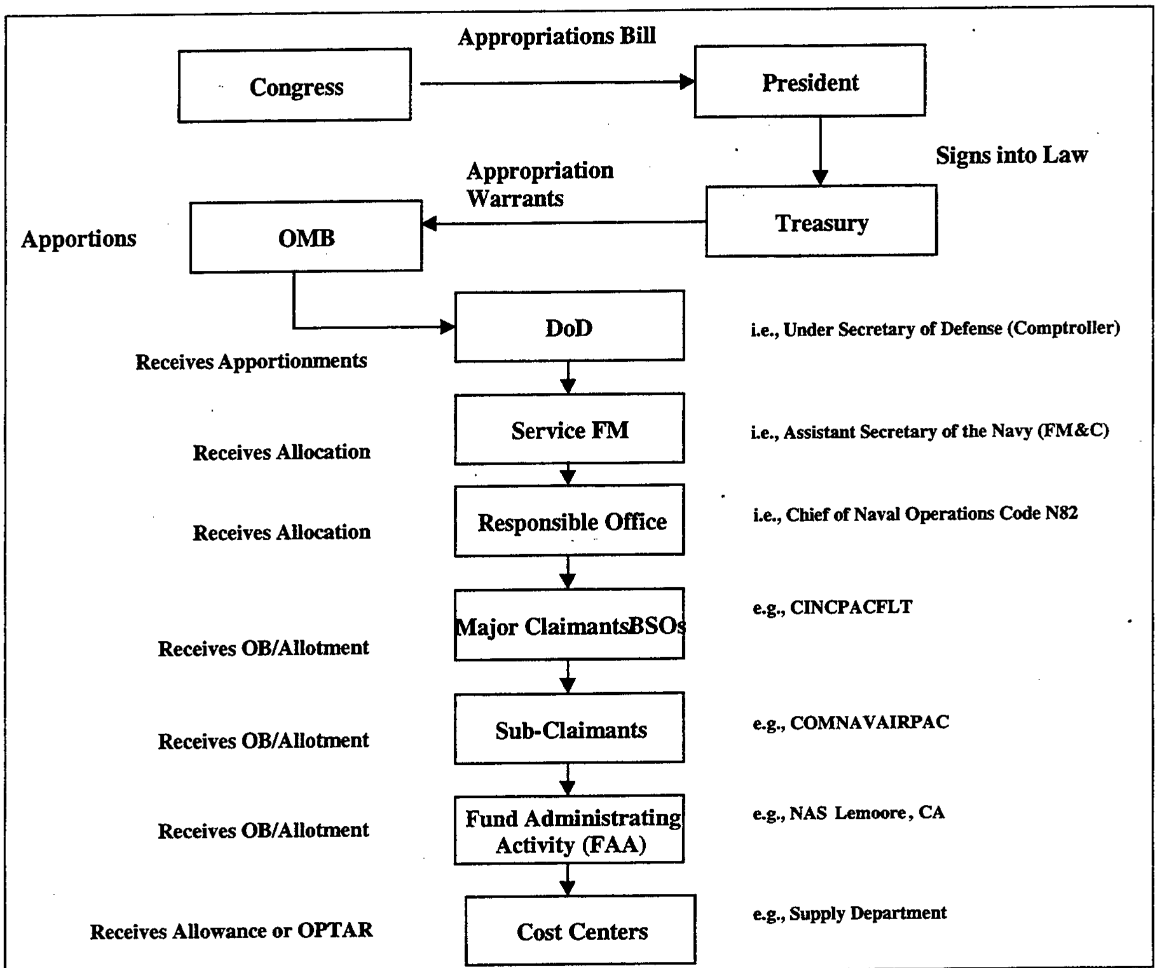

Figure 2 - Flow of Funds

Legal Considerations

To be effective comptrollers, financial managers should be familiar with several laws to avoid any punitive consequences. The Anti-Deficiency Act and other statutes provide DoD with criteria for financial operations. The significant legal requirements relating to budget execution are as follows.

1. 31 USC Section 1301(a): Funds may be used only for the purposes for which they were appropriated. This law is commonly referred to as the "color of money law". Section 1301(a) requires appropriated funds to be used for programs and purposes specified by the appropriation.
2. 31 USC Section 1341: Section 1341(a) prohibits any expenditures and obligations in excess of an appropriation or fund. It also prohibits any federal agency from authorizing a contract or obligation before an appropriation is made available.
3. 31 USC Section 1342: This law prohibits the use of voluntary services. Any services rendered to the government are to be paid for.
4. 31 USC Section 1349: This section outlines the possible adverse personnel actions for officers or employees who violate Sections 1341(a) or 1342. These personnel actions consist of suspension from duty without pay or removal from office.

5. 31 USC Section 1350: This section outlines the possible criminal penalty actions for officers or employees who violate Sections 1341(a) or 1342. These criminal penalties consist of a fine up to $5000.00, imprisonment for as long as two years, or both.

6. 31 USC Section 1512: All appropriations for obligations will be apportioned appropriately in order to meet the required timeline. This measure is put in place to prevent the need to generate deficiency or supplemental appropriations.

7. 31 USC Section 1517: This law prohibits spending in excess of an apportionment (Leventhal, 1997).

Conclusion

The DoN's budget execution process, as explained throughout this appendix, requires coordination from various levels within the organization. To lessen the complexity and streamline the budget execution process, the DoN has implemented the Program Budget Accounting System (PBAS) as a multi-level electronic funds control and distribution system. To further enhance the reader's understanding of the budget execution process, this appendix has identified and explained key budget terminology and major legislation relating to budget execution.

APPENDIX J. THE DEFENSE FINANCE AND ACCOUNTING SERVICE (DFAS)

Background

The Defense Finance and Accounting Service (DFAS) was established in January 1991. The primary goal of DFAS is to eliminate redundancy and decrease the cost of financial and accounting activities in the Department of Defense (DoD). When DFAS was originally established, it inherited 330 field offices, 324 finance and accounting systems and 31,000 civilian personnel (Under Secretary of Defense (Comptroller), May 1999).

There are two types of systems used within DFAS -- accounting and finance. The accounting systems record, accumulate and report financial activity within the DoD. The financial systems process payments to military and civilian personnel, retirees and government contractors.

As of December 1998, DFAS has been able to reduce 330 field offices down to 5 finance centers and 20 operating locations. Accounting and finance systems have decreased from 324 to 109 with a goal of 32 by the year 2003. In addition, personnel reductions have resulted in decreases from 31,000 to 19,000 with a goal of 16,000 by the year 2003 (Under Secretary of Defense (Comptroller), May 1999).

Reform Acts

Several pieces of legislation are responsible for the accounting reforms currently underway within the DoD. These laws and their important provisions are as follows:

1. The National Defense Authorization Act of November 1990 requires that fixed appropriation accounts close or lapse after 5 years. The purpose of this was to fix the problem of unmatched disbursements.
2. The Chief Financial Officer (CFO) Act of 1990 required the DoD and other federal agencies to improve financial reporting. This was to be accomplished by integrating accounting systems, improving internal control procedures, achieving compliance with federal accounting principles and preparing audited financial statements.
3. The Government Management Reform Act (GMRA) of 1994 expanded the CFO Act of 1990 by requiring all government agencies to prepare auditable financial statements by the beginning of fiscal year 1996.
4. The DoD Appropriations Act of 1995 required the DoD to validate that an obligation existed before disbursement of funds on any single expenditure that exceeded $5 million (called prevalidation). The DoD Appropriations Act of 1997 amended the DoD

Appropriation Act of 1995 by lowering the prevalidation amount to $3 million (DFAS, May 1999a).

5. As previously mentioned in Appendix A5, the Federal Financial Management Improvement Act (FFMIA) of 1996 mandates that the DoD and other federal agencies improve their financial management and reporting operations. Beginning in March 1998, FFMIA mandated that auditors for each of the 24 major federal agencies and departments listed in the CFO Act of 1990 must report whether agencies' financial management systems are in compliance with Federal Financial Management Systems Requirements (FFMSR), Federal Accounting Standards (FAS), and the Standard Government Ledger (SGL) at the transaction level (FFMIA, 1996).

Defense Finance and Accounting Service's Plan

In the DFAS 1999 Annual Report to the President and Congress, the DoD summarized the important points of their Financial Management Improvement Plan.

1. Continue standardization of finance and accounting systems within the DoD including military and

civilian payroll, disbursing and financial reporting.

2. Conduct additional Office of Management, Budget (OMB) Circular Number A-76 outsourcing studies relating to existing DFAS operations.
3. Continue consolidation of DFAS operating locations.
4. Adopt best practices, including paperless exchange of financial information, digital signature and travel reengineering.
5. Strengthen internal control procedures by reforming contractor payments, eliminating problem disbursements, increasing computer security and providing accountability for physical assets (Under Secretary of Defense (Comptroller), May 1999).

DFAS Accomplishments

There have been many significant accomplishments since the establishment of DFAS. A few of the major achievements are as follows:

1. The consolidation of DFAS operating sites has resulted in annual savings of $120 million;

2. The elimination of redundant systems has resulted in a 66 percent decrease in the total number of systems.

3. Personnel reductions of 12,000 employees by the end of fiscal year 1999 will have produced a 38 percent reduction in the total civilian workforce.

4. Outsourcing services has produced estimated annual savings of $23 million. This has been accomplished through a combination of competition and improvements implemented as a result of OMB Circular Number A-76.

5. Use of electronic media is achieving the goal of paperless exchange of financial information. Currently, 98 percent of military and civilian payments and 74 percent of contractor payments are processed via Electronic Funds Transfer (EFT) (Under Secretary of Defense (Comptroller), May 1999).

The DoN's Major Accounting Systems

The two major accounting systems that the DoN is currently using are the Standard Accounting and Reporting System (STARS) and the Standard Accounting, Budgeting and Reporting System (SABRS). The Navy is primarily using STARS to account for all of its financial transactions, while the Marine Corps uses SABRS as its financial reporting system. The two accounting systems have similarities and differences, but the financial information they contain is compiled into one database to generate the DoN's financial statements.

Standard Accounting and Reporting System (STARS)

The Navy uses STARS for its general fund accounting and bill paying transactions. The primary purpose of the general fund accounting system is to administer the funds appropriated by Congress. These funds are used by the DoD to accomplish its missions. The Fleet Material Support Office, Central Design Activity is responsible for providing the fleet with the necessary assistance in using STARS. STARS manages approximately $750 billion, provides support to over 1,000 activities and has approximately 15,000 users (DFAS, No date).

The four major subsystems that make up STARS are:

1. Field Level Accounting;
2. Headquarters Accounting and Reporting for fund administrators, major claimants and system commands;
3. One Bill Pay; and

4. Funds Distribution and Department Reporting (DFAS, No Date).

Standard Accounting, Budgeting, and Reporting System (SABRS)

As previously mentioned, the Marine Corps uses SABRS to perform its accounting and reporting functions. This system is used for all appropriations and funds administration at the field level. SABRS currently services 7,500 users and processes over 35 million transactions annually (DFAS, No date).

SABRS operates primarily through manual and mechanized input into a batch update system. The accounting transactions are manually entered into various accounting systems that interface with SABRS, which then updates obligations and expenses. While DFAS maintains ownership of SABRS, the DFAS Kansas City Financial Systems Activity and Computer Data Systems, Inc. (CDSI) provides the necessary support to operate it.

The subsystems that make up SABRS are:

1. Material and Services;
2. Travel;
3. Labor;
4. Expenditures and Collections;

5. Allocations;

6. Systems Management;

7. General Ledger;

8. Budget Execution;

9. Reimburseable; and

10. Plant Property and Report (DFAS, No Date).

DFAS Challenges

Even with all the progress that has been made to date, there are still some major problems that need to be addressed before DFAS can meet all of its goals and requirements.

The DoD system that maintains accountability of physical assets is still experiencing material weaknesses. The General Accounting Office (GAO) estimates that DoD has approximately $1 trillion in assets and no reliable means of accounting for them (GAO, January 1999).

GAO also states that the DoD still lacks an integrated cost accounting system that would allow the Department to accurately report the actual cost of operations. This problem continues to plague the procurement process in terms of forecasting and controlling life cycle costs (GAO, January 1999).

Unrecorded accounting transactions and unmatched disbursements remain a problem. Unrecorded accounting transactions are obligations and/or expenditures that were not entered into the accounting systems. If accounting transactions are not properly recorded in the accounting system, the DoD is unable to produce accurate financial statements that reflect an actual financial position. Unmatched disbursements can occur when the financial information is incorrectly entered into the accounting system. The accounting system relies heavily on the accounting data that the operator enters into it. If the information is entered incorrectly, the system is unable to match the accounting records and update account status. Irreconcilable transactions still total nearly $4 billion and unmatched disbursements are estimated at $22 billion (GAO, January 1999).

The DoD has been unable to determine the future liability for such areas as health benefits, environmental clean-up and hazardous waste disposal. These amounts must be determined and recorded in order for the DoD to report its actual financial position in the future.

Over 80 percent of the data processed by DFAS systems originate in other feeder systems that are not controlled by DFAS. This problem makes it imperative that DFAS work closely with other DoD departments such as personnel, procurement and logistics in order to ensure that proper systems integration occurs in the future (GAO, January 1999).

The combination of all these problems makes it currently impossible for the DoD to produce auditable financial statements or obtain an unqualified audit opinion. An unqualified audit opinion states that the organization's financial statements accurately represent its financial position and no accounting discrepancies were noted.

DFAS Short-Term and Long-Term Strategy

The short-term strategy for DFAS is to fix the problems that are having the greatest impact on existing finance and accounting systems.

1. Determine and report the value of all plant, property, equipment and inventory within the DoD.
2. Provide proper training and professional development for the DoD financial management personnel.
3. Determine projected costs of future liabilities for health care, environmental clean-up and hazardous waste disposal.

The long-term strategy involves making continual improvements to DFAS systems and processes. This will help ensure compliance with all relevant legislation and attainment of all DFAS goals by the year 2003.

1. Continue to standardize core systems and processes including standard general ledger (SGL) and account classification codes.
2. Achieve CFO Act compliance.
3. Integrate systems with non-DFAS business environments, including other federal and private sector entities (Under Secretary of Defense (Comptroller), May 1999).

Conclusion

The original concept of a single accounting and finance system was an unrealistic strategy, which was quickly discarded by DFAS. The incremental approach that was subsequently adopted made more sense due to the size and complexity of the DoD accounting and financial systems (DFAS, May 1999). It makes sense to develop an integrated accounting and financial system but allowances must be made for the diversity within the DoD organization.

The problems of physical asset identification and valuation and the development of a comprehensive cost accounting system are the two major hurdles the DoD has to overcome. Solutions to these two problems are attainable with the assistance the DoD is receiving from private sector financial consultants.

The progress that has been made in system integration and consolidation has been outstanding and has resulted in substantial cost savings. Continued improvement must be achieved in the areas of transaction recording and reconciliation. Unmatched disbursements continue to be a problem, although considerable improvement has been made.

APPENDIX K. CIVILIAN PERSONNEL

As in any organization, one of the major costs of operating an organization is the cost of labor. The federal government is no different from the private sector, offering benefits to its employees such as:

1. Retirement;
2. Health and life insurance;
3. Disability pay;
4. Locality pay;
5. Sick and regular leave benefits; and
6. Holiday pay.

This appendix is intended to provide the reader with a summary of the various benefits (and their costs) civilian employees are entitled to when working for the federal government. These benefits include the Civil Service Retirement System (CSRS), the Federal Employees Retirement System (FERS), the Thrift Savings Plan (TSP), the Federal Employees' Group Life Insurance (FEGLI), the Federal Employees' Compensation Act (FECA), and the civilian awards program.

In addition to being familiar with the costs related to the benefits listed above, there are two budget execution monitors that financial managers must be familiar with in order to budget for civilian employee hours: the labor acceleration rate and Full-Time Equivalents (FTE).

This appendix will also discuss elements of downsizing. In an era of reducing the size of the government, the following programs and processes have been used:

1. Voluntary Separation Incentive Payments (VSIP);
2. Voluntary Early Retirement Program (VERP);
3. Reduction-in-Force (RIF); and
4. Base Realignment and Closure (BRAC).

It is crucial that financial managers are familiar with the applicable laws and the financial obligations related to civilian personnel entitlements to effectively manage labor issues. The programs mentioned above are just a few that have been applied to decrease the size of the government.

Civil Service Categories

The Civil Service system is divided into three categories: General Schedule (GS), Federal Wage System (FWS), and Senior Executive Service (SES).

General Schedule (GS)

GS employees' salaries are based on an annual pay scale, GS levels and steps. The GS system has 15 grades or salary levels. Each level includes 10 steps within which employees are advanced based on satisfactory job performance. All GS employees enter the system at various levels, but they all begin at step one. In order to qualify for a "within-grade increase," there are specified time requirements that must be met for each step increase, as follows.

1. The required waiting periods for steps 2, 3, and 4 to be advanced are 52 weeks;
2. The required waiting periods for steps 5, 6, and 7 to be advanced are 104 weeks; and
3. The required waiting periods for steps 8, 9, and 10 to be advanced are 156 weeks (Federal Employees News Digest, Inc., 1999).

GS employees may also be categorized as full-time permanent (e.g., greater than 32 hours per week), part-time permanent (e.g., 16-32 hours per week), temporary (e.g., less than a year), or intermittent (e.g., seasonal positions) billets (Naval Postgraduate School, 1999). These categories determine eligibility for benefits discussed in later sections.

Within the GS, types of appointments such as temporary, term, career-conditional, and career are established to further categorize these employees (Joseph and Whitehead, 1999).

Temporary appointments are referred to as "short-term" or "urgent" and are considered limited employment. The

Office of Personnel Management (OPM) approves all temporary appointments. These appointments expire automatically on a specific date unless the appointment is terminated prior to the prescribed date or is extended. Agencies which have temporary appointments may extend the expiration date in increments of up to one year up to a maximum of two years without requesting approval from OPM. Any extensions beyond the two year limit must be submitted to OPM for approval.

Term appointments are considered to be nonpermanent positions. Like the temporary appointments, the term appointments have a specific termination date. The maximum employment range for a term appointment is four years. Term appointments are eligible for promotions, within-grade increases, reassignments, and retirement and insurance benefits (Joseph and Whitehead, 1999).

A career-conditional appointment offers a possible continuing position in the federal service. The person selected for this appointment is in a probationary status during their first year. After successfully completing the probationary period, the member must serve three continuous years under the career-conditional appointment in order to attain career status (Joseph and Whitehead, 1999).

A career appointment offers permanent status and the highest possible job protection. In addition, if they elect to voluntarily leave federal employment, career appointees have permanent reinstatement eligibility. This allows the federal employee the option to return to federal employment without having to challenge a Civil Service examination (Joseph and Whitehead, 1999).

Federal Wage System (FWS)

FWS employees, unlike the GS employees, are paid on an hourly wage pay scale. Similar to GS employees, FWS employees follow grades and steps. Within the FWS there are 15 grades, with each grade consisting of 5 steps. FWS employees will enter the system at various grades, but all employees will start at step one. Wage schedules will be adjusted during the year based on the outcome of the annual wage survey in each individual wage area (Federal Employees News Digest, Inc., 1999). FWS positions are typically filled by skilled labor. There are three categories within the FWS system:

1. Wage Grade (WG) - a non-supervisory position;
2. Wage Leader (WL) - a leader and performer, but does not possess any supervisory responsibilities; and
3. Wage Supervisor (WS) - full-time supervisor (Naval Postgraduate School, 1999).

FWS employees have within grade (WIG) step increase requirements. The FWS WIG requirements are shown in Figure 1.

Steps	Requirement
1	Normal entry level at appropriate grade
2	6 months waiting period
3	18 months waiting period
4	2 years waiting period
5	2 years waiting period

Figure 1 - FWS Within Grade (WIG) Increase Requirements

FWS employees are entitled to benefits discussed later, with the exception of locality pay. The wage schedules already reflect adjustments based on the location.

Senior Executive Service (SES)

SES employees hold senior executive and management positions. SES positions do not have grades; rather, they are classified above the GS-15 level using a six-level basic pay rate, Executive Service (ES), ES-1 through ES-6. The minimum rate of pay for a SES may not be below 120 percent of the basic pay of a GS-15, step 1 ($89,728), and the maximum pay may not exceed an Executive Level IV pay rate ($118,400). Primary factors in determining SES pay rate increases are an employee's performance, increased responsibilities, or assignment to a higher position. SES employees are eligible for basic pay, performance awards, rank awards, annual leave, locality pay, health and life insurance, and retirement (HR Executive Resources, 1999).

Retirement Benefits

Among the associated costs of employing federal employees is the mandated retirement plan. This section will summarize the two retirement plans that the federal government offers its civilian personnel, i.e., the Civilian Service Retirement System and the Federal Employees Retirement Plan.

Civil Service Retirement System (CSRS)

The Civil Service Retirement System (CSRS) is a retirement plan that applies to federal employees who were hired before 1984. CSRS provides an annuity benefit based on the federal employee's salary and the number of years of service. CSRS participants may volunteer to retire at age 55 with 30 years of service, at age 60 with 20 years of service, or at age 62 with at least five years of service. Involuntary retirement may occur at any age with more than 25 years of service, or at age 50 with 20 years of service (Joseph and Whitehead, 1999). CSRS participants are eligible to participate in the Thrift Savings Plan (TSP) and may contribute a maximum of 5 percent of their basic pay each pay period. This will be discussed further within the this appendix.

The Federal Employees Retirement System (FERS)

Federal employees who were hired on or after 01 January 1984 are eligible to participate in the Federal Employees Retirement System (FERS). FERS is an annuity plan that takes into consideration the federal employee's salary and number of years served in order to calculate his/her retirement payments. The retirement formula is not as straight forward as that for the CSRS participant because FERS takes into consideration Social Security requirements. Federal employees eligible for FERS are also required to pay Social Security and Medicare taxes. These deductions make them eligible for these benefits upon retirement. The federal employee and the government pay an equal share of the Social Security and Medicare tax, which is currently at 7.65 percent (Social Security Administration, 1998).

The minimum requirement for a FERS participant to retire is that he/she must be 62 years of age and have at least ten years of service. The retirement benefits will vary depending on the federal employee's age along with the number of years served (Joseph and Whitehead, 1999).

The Thrift Savings Plan (TSP)

The Thrift Saving Plan (TSP) emerged when Congress enacted the Federal Employees Retirement System Act of 1986, providing federal employees a retirement plan similar to the private sector's "401(K)" plan. TSP is a voluntary retirement benefit plan offered to federal employees enrolled in the Federal Employees Retirement System (FERS), or the Civil Service Retirement System (CSRS) and who are full or part-time. The TSP is a tax deferred retirement program that allows federal employees to contribute a certain percent of their basic pay per pay period.

Under FERS, the federal agencies are required to automatically contribute towards employee retirement plans. The agencies contribute at least 1 percent of every employee's base salary per pay period. In addition to this contribution, the agencies must match each individual employee's contributions from 1 percent to 3.5 percent. Any employee contribution greater than 4 percent will be matched with a flat 4 percent employer contribution. FERS participants who elect to participate in TSP may contribute a maximum of 10 percent of their basic pay each pay period in order to help them save for their retirement (Federal Retirement Thrift Investment Board, 1995). Figure 2 illustrates the breakdown and total percentages contributed by the federal employee subject to FERS and the federal agency (Federal Retirement Thrift Investment Board, 1996).

Employees' Contribution	**Agencies' Contributions:** Automatic Contribution	Matching Contribution	**Total**
0%	1%	0%	1%
1%	1%	1%	3%
2%	1%	2%	5%
3%	1%	3%	7%
4%	1%	3.5%	8.50%
5%	1%	4%	10%
6% -10%	1%	4%	11% -15%

Figure 2 - Percent of Basic Pay Contributed to FERS Employees' Account

In contrast to FERS, CSRS participants are not entitled to the automatic one percent contribution provided by the respective agency or the privilege of their agency matching their contributions (Federal Retirement Thrift Investment Board, 1995).

TSP benefits are determined by how much the federal employee and employer (if applicable) have invested in the plan and how well the fund(s) have performed. Federal employees who participate in TSP may invest any portion of their contribution into three different funds:

1. Government Securities Investment (G) Fund;
2. Common Stock Index Investment (C) Fund; and
3. Fixed Income Index Investment (F) Fund.

The G Fund invests in short-term nonmarketable U.S. Treasury securities. These securities can mature from one business day to four days.

The C Fund invests in the Wells Fargo's Equity Index Fund; this fund performs relatively close to the Standard & Poor 500 stock index. The C Fund offers the investor the opportunity to diversify their investment while participating in the U.S. stock markets.

The F Fund invests in Wells Fargo's U.S. Debt Index Fund, a fund that represents U.S. Government, corporate, and mortgage-backed securities in the fixed-income securities market. The fixed-income securities act like bonds. The investor receives semiannual interest payments until the security matures and upon maturity of the bond the investor will receive the amount borrowed by the principle holder (Joseph and Whitehead, 1999).

Federal Employees Health Benefits (FEHB) Plans

Civilian employees who are permanent and term employees are entitled to participate in the Federal Employees Health Benefits (FEHB) program. The employee is responsible for approximately one-third of their health insurance while the local activity is responsible for the remaining two-thirds. Various health plans are offered to civilian employees such as Health Maintenance Organizations (HMO) and Fee-for-Service (FFS) plans. An HMO is a health care plan that offers care through a network of physicians and hospitals in certain geographic or service regions. A FFS plan allows the employee the flexibility to use any physician or hospital (Office of Personnel Management, 1998).

Federal Employees' Group Life Insurance (FEGLI)

The Federal Employees' Group Life Insurance (FEGLI) is group term life insurance that is offered to federal employees and retired federal members. One advantage of FEGLI is that it offers its full and part-time federal employees low rates. Temporary and intermittent federal employees are not eligible for this benefit because their appointments are limited to 1 year or less (Office of Personnel Management, October 1998).

Another advantage for federal employees is that the government pays one-third of the cost of their basic life insurance. The basic life insurance payout is rounded to the next $1,000 of an employee's annual basic salary plus $2,000 or a minimum of $10,000. FEGLI coverage for SES employees is equal to their annual basic pay plus $1,000 (Joseph and Whitehead, 1999).

Federal Employees' Compensation Act (FECA)

The Federal Employees' Compensation Act (FECA) provides tax free compensation benefits to civilian employees for disability caused by injury incurred while performing their duties. In addition, the FECA provides payment of benefits to dependants if job-related injury or disease causes the employee's death (Department of Labor, 1996). FECA covers both permanent and temporary employees. In the event that an employee is injured while performing his/her duties, he/she is entitled to two-thirds of their salary for employees without dependents, or three-fourths of their salary for employees with dependents. Another benefit entitlement includes schedule awards, which are payments for the permanent loss, or loss of use of a part of the body, such as an arm or leg. Schedule awards also include benefits to survivors in the event of work-related death (Department of Labor, March 1998).

To understand how FECA works at the activity level, an interview with the Naval Postgraduate School, Comptroller, Ms. Megan Reilly, was conducted on 21 October 1999. Ms. Reilly stated,

> In order for activities to estimate their FECA bill for a fiscal year, they have to heavily rely on

historical data (from the Safety Office and Human Resources Office) to determine the FECA dollar figure. In addition, billing for FECA will vary from fiscal year to fiscal year because it depends on various factors such as the number of injuries, the total amount of medical bills, and lost workdays within a fiscal year. Finally, the FECA bill is two years in arrears (e.g., fiscal year 1998 FECA bill is paid by activities in fiscal year 2000) and activities are required to pay the FECA bill amount upon receipt out of the activities' Operations and Maintenance appropriation.

Locality Pay

The Federal Employees Pay Comparability Act (FEPCA) of 1990 required the federal government to adjust annual pay rates for GS and SES employees if a disparity between the pay and that of non-federal employees doing the same work in the same geographic area existed. Locality pay was implemented in the federal government in 1994 for the 48 contiguous states (Naval Postgraduate School, 1999). As economics and the balance of supply and demand for specific professional occupations influence labor markets, the FEPCA attempts to increase the GS and SES employees' pay rate at a percentage that is comparable to the private sector (GovExec, 1996). In 1999, locality raises ranged from a low of .44 percent to a high of .92 percent (Joseph and Whitehead, 1999).

Sick Leave

Sick leave is a time-off benefit that civilian employees accrue every pay period. Full-time employees may accumulate sick leave at the rate of 4 hours per pay period (13 days per year). There is no limitation on the number of sick leave hours an employee may accrue or use within a fiscal year. The employee may use their sick leave for various reasons such as being incapacitated due to illness or injury, or for family care which is to care for a spouse, parent, or children (Joseph and Whitehead, 1999).

Leave Accrual

The basic workweek for full-time employees consists of 40 hours which do not extend over more than 6 of any 7 consecutive days. A full-time employee's normal schedule will include 8.5 hours each day which includes a 30 minute unpaid lunch break. Based on the normal workweek schedule, an employee's annual leave accrual guidelines are:

1. 0-3 years of service: 4 hours per pay period (13 days per year);
2. 3-15 years of service: 6 hours per pay period (20 days per year); and
3. 15 years or more of service: 8 hours per pay period (26 days per year) (Joseph and Whitehead, 1999).

Accrued leave may be used for vacations, personal matters, and/or emergency situations. The civilian employee has the right to use his/her leave, but it is subject to the management's right to schedule the leave. The maximum number of leave hours that may be accrued is 240 hours (30 days). If the 240-hour limit has been exceeded, the "use or lose" rule comes into effect (Joseph and Whitehead, 1999).

Another means by which a civilian employee can be authorized time-off from work is leave without pay (LWOP). LWOP is an approved absence from work in a non-pay status. Extended periods of LWOP may be granted on a case-by-case basis (e.g., to attend school or as a result of incapacitation due to illness or injury) (Joseph and Whitehead, 1999).

Holiday Pay

Full-time federal employees are entitled to ten paid holidays per year. If a holiday falls on a Saturday, the employee may take Friday "in lieu of" the holiday. If a holiday falls on a Sunday, the employee may take Monday. Part-time employees are not entitled to the "in lieu of" holiday policy (Joseph and Whitehead, 1999).

The Civilian Awards Program

The Department of the Navy (DoN) has various civilian award programs that it uses to recognize its federal employees' outstanding achievements and to promote productivity in the workplace. These civilian award programs are categorized as non-monetary, monetary and time-off awards.

The non-monetary awards are generally issued as letters, plaques, medals, or certificates honoring a federal employee's superior performance. These awards do not have any cash or time-off incentives attached to them.

Another form of award for recognizing an employee's superior performance is offering monetary awards. There are four ways of issuing monetary awards: 1) Special Act Award; 2) On-the-Spot Award; 3) Performance Award; and 4) Quality Step Increase (QSI) Award.

Special Act Award - This award, used as a group or individual effort award, may be given at any time. The dollar amounts of this award are usually $25 or higher. For any dollar amount exceeding $10,000, the request must be approved by the Office of Personnel Management (OPM) (Administrative Personnel, 1999).

On-the-Spot Award - This award is intended to immediately recognize an employee's outstanding performance and reinforce the employee's one-time accomplishment. This cash award ranges from $25 to $750.

Performance Award - Like the Special Act Award, this award may be given to a group or individual who has displayed superior performance. The cash payment may be a specific dollar amount or a percentage of an employee's basic pay. Generally, the maximum percentage an employee is awarded is 10 percent of their basic pay. Any cash awards given that range between 10 to 20 percent of an employee's basic pay must be approved by the Secretary of the Navy (Human Resources, June 1998).

Quality Step Increase (QSI) Award - QSI awards are another method of recognizing sustained quality performance. They may be used as an alternative to a cash award. The expectation of granting this award is that the employee's performance will continue in the future. The employee may be advanced by one step. FWS employees are not eligible for this award (Human Resources, June 1998).

Time-off awards are supplementary forms of recognizing superior performance without the issuance of cash. Such awards grant an employee a certain amount of time-off during regular duty hours. The time-off award does not count against the employee's regular leave balance (Human Resources, June 1998).

Labor Acceleration Rate

As a financial manager, there are a couple of calculations one should be familiar with in order to budget the costs associated with civilian labor. One of these formulas is known as the labor acceleration rate. The labor acceleration rate determines the cost per productive hour of civilian personnel. These rates take into consideration the estimated cost of fringe benefits throughout a given year. In addition, the labor acceleration rate projects the cost of civilian labor for reimbursable projects.

Local activities are responsible for generating their own labor acceleration rate, which is recalculated after every pay period. Adjustments to the rate will fluctuate month-to-month to ensure the local activity has enough funds to pay for civilian benefits (e.g., holiday pay and annual and sick leave). The components used to calculate this rate are:

1. Total leave costs based on fiscal year estimates (A);
2. Total fringe benefit costs (e.g., retirement, life insurance, health benefits, and Social Security) (B); and
3. Total civilian payroll based on fiscal year estimates (C) (NAVCOMPT, 1988).

The formula used to calculate the labor acceleration rate is:

$$\frac{A + B}{C}$$

Full-Time Equivalent Equation

The financial manager should be familiar with the Full-Time Equivalent (FTE) ceiling. One FTE is equivalent to a workyear, and these terms are used interchangeably. The Federal Work Force Restructuring Act of 1994 mandates statutory ceilings on the total number of FTEs that can be executed during each fiscal year. The Department of the Navy's FTE ceilings are issued by the Under Secretary of Defense (Personnel and Readiness). To ensure the FTE ceiling is not breached, activities reconcile locally generated FTE reports with the Civilian Personnel Resource Reports (CPRR) which are compiled by the Defense Finance and Accounting Service (DFAS) on a monthly basis. The CPRR feedback reports are used to determine if any adjustments to local FTE reports are required to reconcile the current/prior month. If FTE targets are underexecuted at the end of a fiscal year, this may result in the reduction of an activity's FTE and/or funding (CNO, December 1996).

Activities use FTEs as a budgeting tool to estimate personnel-related requirements. The FTE estimates for each agency are calculated at the time of the annual budget review for the fiscal year in progress and the following fiscal year. Managers must ensure that the FTE estimates are consistent with all applicable laws.

The FTE equation accounts for straight time as well as annual leave and sick hours. This equation does not take into consideration the following:

1. Overtime;
2. Compensation (Comp) hours;
3. Leave without pay; and
4. Lump sum leave hours (Field Support Activity, 1998).

An example of calculating the FTE is as follows:

> One FTE (or workyear) equals 8 paid hours per day multiplied by the number of paid days in any fiscal year (FY). For instance, in FY 1998 there were a total of 261 paid days. Multiplying 261 paid days by 8 hours a day equates to 2,088 paid hours in FY 1998. If an FTE ceiling is given as 100, then this equals 208,800 hours (e.g., 100 * 2,088 paid hours = 208,800 hours).

The 208,800 annual paid hours in this example is the activity's maximum number of FTE for that fiscal year. An activity can optimize their authorized FTE by utilizing any combination of hours worked by full-time, part-time and temporary employees that does not exceed the ceiling (Field Support Activity, March 1998).

Downsizing

Since the late 1980s, downsizing has been a means of reducing the size of the government by streamlining organizations within the federal government. The Base Realignment and Closure (BRAC) process was a major effort that was implemented to help the DoD reduce its infrastructure and redistribute its workforce. This effort decreased the number of employees by approximately one million through 1993 with an additional 800,000 by the end of 1999 (Federal Retirement Thrift Investment Board, 1999).

BRAC not only reduced the size of the force, it also redirected funds used for non-value-added facilities to provide more funds for training, modernizing weaponry, and increasing the quality of life of service members (Cohen, 1999b). In Secretary of Defense William S. Cohen's remarks to the Department of Defense Conference on Base Reuse, he stated,

> …as a result of the four rounds of BRAC, we have saved some $3.5 billion to date; we will save over $25 billion by the year 2003; and the reason that we need two more rounds of BRAC is that we expect to save some cumulative $20 billion total, and then $3.5 billion roughly, or $3 billion a year thereafter (Cohen, 1999b).

Other tools provided for personnel reductions in the DoD are the Voluntary Separation Incentive Pay (VSIP), the Voluntary Early Retirement Program (VERP), and the Reduction-In-Force (RIF). An overview of these programs is provided below.

Voluntary Separation Incentive Pay (VSIP)

The Voluntary Separation Incentive Pay (VSIP), also known as a buyout, is a program that was implemented to offer federal employees the opportunity to voluntarily leave government employment to avoid involuntary separation based on the DoD's effort to reduce its workforce. In October 1992, the DoD was given buyout authority to last through 1997, but in 1999 it was extended to September 30, 2003 (FEDweek Weekly Newsletter, October 1999).

The VSIP program allows the federal employee to separate from government employment and receive up to a maximum of $25,000. Generally, severance pay is offered to employees who are involuntarily separated from federal service. For those employees who choose to leave the federal government through an incentive program, their separation is considered to be voluntary. The incentive dollar amount does not take into consideration taxes, Medicare or Social Security deductions. These deductions are taken before the federal employee receives his/her incentive payment.

The two factors to consider when calculating an employee's incentive payment are the employee's age and the number of years served. The activity is responsible for paying the VSIP incentive payments and the funding used for this program is taken out of the activity's Operations and Maintenance appropriation (Federal Retirement Thrift Investment Board, 1999).

Voluntary Early Retirement Program (VERP)

The Voluntary Early Retirement Program (VERP) offers federal employees the opportunity to voluntarily leave federal employee before the standard retirement requirements are met. The purpose of VERP is to provide federal agencies a mechanism to reduce the number of employees who would probably be separated during a downsizing process. The VERP allows the eligible employees the option to qualify for retirement. The normal eligibility requirements for an employee to retire are:

1. Have a minimum of 30 years of federal service and is at least age 55; or
2. Have a minimum of 20 years of federal service and is at least age 60; or
3. Have a minimum of 5 years of federal service and is at least age 62 (Joseph and Whitehead, 1999).

The Office of Personnel Management (OPM) authorizes federal agencies to temporarily lower the age and service requirements to allow a large number of federal employees to retire and encourage more voluntary separations. The VERP requirements are:

1. Have 20 years of federal service at age 50; or
2. Have 25 years of federal service without a specified age limit (Joseph and Whitehead, 1999).

Reduction-In-Force (RIF)

As part of the DoD's workforce reduction efforts, the Office of Management and Budget Circular Number A-76: *Performance of Commercial Activities* mandates the continual study of functions performed within the DoD to determine if outsourcing is another means of capturing cost savings while shrinking the force. This additional requirement may necessitate a Reduction-In-Force (RIF).

Generally, when an organization is restructured it eliminates, adds, or redistributes functions performed in an organization. This could result in a RIF. Federal employees at the GS level must be given a minimum of 60 days notice before the effective date of the RIF. Federal employees who are subjected to RIF are furloughed for greater than 30 days, separated, demoted, or reassigned because of outsourcing, insufficient workload, lack of funds, reengineering, or reclassification of a employee's position. Furlough is defined as an employee in a temporary nonduty and nonpay status for greater than 30 consecutive calendar days, or more than 22 workdays if based on a discontinuous basis, but not exceeding more than one year (Office of Personnel Management, 1998).

Although RIF has been used, it is considered to be the last resort because the short-term effects of the RIF are considered to be very costly both in fiscal terms and morale. Federal employees who are RIF'd are entitled to a lump-sum payment, severance pay, relocation costs, and any saved pay upon the federal employee's release. If a RIF action is to be implemented, the Office of Personnel Management (OPM) must grant the approval to initiate the RIF process (Joseph and Whitehead, 1999).

Conclusion

As a financial manager, there are several aspects to be understood when calculating the cost of a federal employee. It is crucial that financial managers are constantly updated with the applicable laws and guidelines to ensure that civilian employees' rights and benefits are not violated. In addition, the knowledge gained from being familiar with the regulations can help activities project and manage civilian labor costs to ensure that appropriated funds are properly used.

Financial managers may have to apply innovative cost saving strategies when challenged with choices of redistributing funds in this time of limited fiscal resources. When faced with a fiscal year budget cut, financial managers have many options available to them to reduce labor costs such as granting LWOP or using non-monetary awards in lieu of cash awards.

Finally, as the DoD continues the BRAC process, more civilian positions will be reassigned and/or eliminated in order for the DoD to achieve a smaller infrastructure and redistribute assets in order to increase training opportunities, purchase weaponry, and modernize the force. The federal government has implemented programs such as VSIP and VERP, to reduce the number of civilian employees who would be involuntarily separated from the federal government. The focus of these programs is to increase efficiency and reduce costs.

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APPENDIX L. THE DEPARTMENT OF THE NAVY'S WORKING CAPITAL FUND

As the Department of Defense (DoD) seeks new methods of accomplishing its mission with fewer dollars, concepts such as the Working Capital Fund (WCF) have been implemented. The WCF helps the DoD components produce goods and provide services to its customers at lower prices on a reimbursable basis. This appendix will initially discuss how the WCF differs from appropriated funds. Subsequent sections will provide a background on the inception of the Department of the Navy's (DoN) Working Capital Fund (WCF) and detail how the WCF functions as a cost saving mechanism. Lastly, this appendix will cover some of the major problems associated with the Navy's WCF as documented in the General Accounting Office's (GAO) reports.

The WCF versus Appropriated Funds

The DoD funds its requirements both with the WCF and appropriated funds. The WCF is a financing entity that is supported by a revolving fund concept. The WCF promotes activities that function more efficiently through the control of costs. All activities within the WCF operate under the unit cost concept, i.e., total costs divided by a measurable output. Generally, WCFs do not receive annual appropriations from Congress. Congressional appropriations are usually provided only to start, increase the size, or replace significant losses to the WCF. The initial appropriation, or corpus, provides a base of resources used to produce goods and provide services (Under Secretary of Defense (Comptroller), December 1994).

Appropriations are funds approved by Congress and are statutes that provide budget authority for the DoD to incur obligations for specific purposes (Under Secretary of Defense (Comptroller), December 1994).

One consequence of appropriation funding is the "use or lose" phenomenon that occurs towards the end of the fiscal year. Commands struggle to reduce their funds to near zero by the end of the fiscal year. The driving force to spend all funding stems from the idea that if funding is not spent, the following fiscal year's allocations will be less or programs may be cut.

Unlike appropriations, there are no fiscal year limitations on WCFs. This eliminates the need for commands to hoard dollars at the beginning and spend excess dollars at the end of the fiscal year.

History of the Revolving Fund Concept

The National Security Act of 1947 authorized the use of the revolving fund concept. The revolving fund concept operates on a reimbursable basis. This means that a working capital activity initially pays for the product or service, and in turn is reimbursed by the customer. A revolving fund activity's existence depends on a customer-provider relationship.

Today's revolving fund activities evolved from two categories: Stock Funds and Industrial Funds. Stock Funds procured materials in volume from private industries and maintained an inventory of the acquired goods. The Stock Fund activities in turn would sell goods to authorized customers who needed the items to perform their duties (e.g., weapons system readiness or personnel support items). Industrial Fund activities provided industrial and commercial goods and services (e.g., depot maintenance and transportation) (Under Secretary of Defense (Comptroller), 1994).

The Defense Business Operating Fund (DBOF)

As the revolving funds continued to evolve, the DoD established the Defense Business Operations Fund (DBOF) in 1991, which was managed by the Under Secretary of Defense (Comptroller). The DoD established the DBOF to foster a more business-like culture within selected Defense operations. The DBOF was intended to expand on the revolving fund concept by connecting cost and performance.

In addition, the DBOF concept required the Fund Managers to operate within cost goals set during the formulation of the annual operating budget.

The DBOF Components were responsible for providing services and goods to other DoD and non-DoD activities on a reimbursable basis. Activity groups acquired their initial working capital through an appropriation or "corpus" and used these funds to finance the initial costs of producing goods and/or services. A corpus is a "one-time" congressional appropriation that is used to start a WCF. The intent of the WCF is that it will continually receive revenues from its customers.

One objective that the DBOF was to achieve was to reduce the cost of procuring goods and providing services. To achieve this objective, managers of activity groups were required to set their prices based on full-cost recovery. Full-cost recovery included all the costs associated with producing or providing the service along with any overhead and general and administrative support costs (Under Secretary of Defense (Comptroller), 1994).

The types of costs that are taken into consideration when estimating project or service costs are direct and indirect costs. Direct costs are costs that can be directly linked to or identified with the production of the final product or service (e.g., direct labor or direct materials).

Indirect costs are costs that an activity incurs that cannot be directly linked to or identified with the production of the good or service (e.g., supervision over multiple product lines). Indirect costs include overhead and General and Administrative (G&A) costs. Overhead costs include transportation costs, indirect labor, utilities, and any additional costs which may be considered to be appropriate at the market price. The G&A costs are associated with the administration operation (e.g., supervisor salaries and office supplies) (Naval Financial Management Career Center, 1997).

The Defense Working Capital Fund

In December 1996, the Under Secretary of Defense (Comptroller) restructured DBOF, establishing four working capital funds: Army, Navy, Air Force, and Defense-wide. The reason for this was to establish the DoD Components' responsibilities for managing the functional and financial aspects of their respective activity groups. Like the DBOF, the WCF operates under the revolving fund concept. The WCF is financed through continuing operations, and the customer is responsible for replenishing the working capital (Naval Financial Management Career Center, 1997).

As of fiscal year 2000, Defense Agencies will operate ten activity groups within the Defense Working Capital Fund. The Defense Logistics Agency (DLA) will operate five activity groups; the Defense Finance and Accounting Service (DFAS) and the Defense Information Systems Agency (DISA) will each operate two; and the Defense Security Service (DSS) will operate one.

This excerpt from the *Defense-Wide Working Capital Fund Defense-Wide FY2000 Budget Estimates Defense-Wide Summary* highlights the mission of each activity group.

> DFAS was formed in January 1991 from the Military Services finance and accounting functions to improve financial accounting support to DoD-wide activities and to reduce costs by adapting standards policies, procedures, forms, data, and systems; streamlining and consolidating operations; and eliminating redundancies.
>
> DISA was reorganized in 1991 from the former Defense Communications Agency. Its responsibilities include obtaining common telecommunication and information services for command and control and providing assistance in other communication support to meet customer needs.
>
> DLA, formed in the early 1960s, operates the Distribution Depot, Reutilization and Marketing, Information Services, Supply Management, and Defense Automated Printing activity groups. Distribution Depots receive, store, and ship inventory. Reutilization and Marketing functions include the reutilization of excess and surplus property and the donation, sale, or disposal of surplus DoD personal property. Supply Management conducts the procurement, inventory management, and technical operations functions for consumable defense inventory. The DLA Information Services activity group performs central design agency functions. The Defense Automated

Printing Service provides printing services to customers.

DSS, formerly known as the Defense Investigative Service, was formed in 1972. The mission of DSS is to administer the Personal Security Investigations (PSI) program and the National Industrial Security Program (NISP) for the Department. The mission of the PSI program is to conduct background investigations on individuals assigned to or affiliated with the Defense Department. The purpose of the NISP program is to ensure that private industry, while performing government contracts, properly safeguards classified information in its possession (Office of the Secretary of Defense, February 1999).

As a result of the fiscal year 2000 restructure of activity groups, the DSS activity group was included while the Joint Logistics Systems Center was eliminated. This change also resulted in the U.S. Transportation Command activity group being shifted to the U.S. Air Force. Lastly, the Defense Commissary Agency, previously part of the Defense-Wide Working Capital Fund, became a separate Defense Working Capital Fund (Office of Secretary of Defense, February 1999).

The primary goals of the WCF, and its predecessor the DBOF, are twofold: 1) to focus attention on the total costs of carrying out certain critical DoD business operations, and 2) to manage those costs to provide quality goods and services at the lowest costs (GAO, May 1997).

At the beginning of the budget formulation process, the Defense Working Capital Fund activities are required to adhere to the budget guidance mandated by the Office of Under Secretary of Defense (Comptroller) and their respective services. The budget guidance includes information pertaining to civilian pay raises, inflation planning factors, and fuel rates. Budget formulation is a cooperative effort between the customers and providers. The joint effort between both parties is essential to determine available resources, projected requirements, and provider capabilities (Naval Financial Management Career Center, 1997).

Both customers and providers are required to provide Budget Estimates Submissions (BES). The Major Commands (e.g., Naval Supply Systems Command (NAVSUP) and Naval Sea Systems Command (NAVSEA)) are responsible for reviewing the BES to ensure that the subordinate commands have complied with the program guidance, DoD policy, and statutory requirements. The estimates are forwarded to the component level and ultimately, to the SECDEF and the Office of Management and Budget (OMB). The budget estimate submissions are continually reviewed for compliance with SECDEF objectives. The Office of Secretary of Defense (Comptroller) reviews the estimates and makes recommendations to the Services for adjustments.

The WCF's annual budgets consist of the capital and operating budgets. The capital budget represents the amount of financial resources that are authorized for use in the acquisition of capital assets. The operating budget represents an activity's or a component's operating costs, which also includes depreciation and amortization expenses (Under Secretary of the Navy (Comptroller), May 1998).

The WCF is structured around the functions of providing goods and services to the DoD and non-DoD customers. Proposed budgets are prepared for these functions based on anticipated workload and expenses. The Components may develop, report, and use subsidiary rates (e.g., engine rate, airframe rate, etc.) as long as these subsidiary rates are included into one composite rate for the activity group. The purpose of the composite rates is to recoup all costs associated with the activity group operating and capital budgets and prior year losses/gains. Simultaneously, appropriated fund customers include in their budgets any planned requirements for goods and services from WCF (Under Secretary of Defense (Comptroller), December 1994).

The respective budgets are submitted by the Components to the Under Secretary of Defense (Comptroller). During the budget process, the Under Secretary of Defense (Comptroller) reviews and approves all final rates and prices developed for the President's budget submission during the Budget Review in December. The Under Secretary of Defense (Comptroller) sets composite rates for each function. Each activity group may propose detailed rates that break out composite rates by activity or product line. If the rates are approved by the Under Secretary of Defense (Comptroller), these rates will be used in the final budget development and execution (Under Secretary of Defense (Comptroller), 1998). Rates are keyed to a unit of output that is unique to each function and are stabilized for the budget year, with the exception of depots (Defense Technical Information Center, 1999).

The primary managerial tool used to achieve the objectives of full cost recovery was through Unit Cost Goals. Other tools used are Stabilized Rates, Net Operating Result, and Accumulated Operating Result. These terms will be further explained below.

Unit Cost Goal

Setting prices to ensure that funds achieve a break-even point is a complex and difficult task to accomplish. Unit cost goal refers to estimating costs and outputs. Unit cost goals are simply computed by dividing estimated costs by estimated outputs. The process to determine unit cost goals begins as early as two years prior to establishment of the prices (i.e., rates) with each activity group developing workload projections for the budget year.

Stabilized Rates

A stabilized rate is one of the basic operating principles of the WCF. The intent is to give individual program managers and customers the guidance they need to make cost effective program decisions. Each activity is responsible for developing and establishing rates to recover operating costs. Stabilized rates are not allowed to change for an entire fiscal year, except those rates established by air rework facilities and shipyards. If an activity group needs to change its rate during a fiscal year, a request from the WCF activity must be submitted via the chain of command to the Department of Defense (Comptroller) for approval (Naval Financial Management Career Center, 1997).

The Rate Determination Process

The process of developing the predetermined rates activity groups charge involves determining the estimated workload based on the customer's input and the estimated labor required to complete the work. The provider must prepare a budget that identifies the labor, material, and other expected costs. Finally, the provider is required to develop prices, that, when applied to the projected workload, should allow the provider to recover operating costs from the customers and losses or gains (GAO, May 1997).

Net Operating Result (NOR) and Accumulated Operating Result (AOR)

The goal of a WCF activity is to achieve a break-even result. Prior to determining if an activity has achieved a break-even result, an activity must calculate the unit of output. The unit cost is calculated by dividing the actual unit of output by the total cost of the actual workload. The unit cost is compared to the unit cost goal and a variance is determined.

The Net Operating Result (NOR) provides the expected overall financial standing for an activity in a given fiscal year. The NOR calculation is performed by subtracting the activity's total revenues from its expenses. To determine an activity's long-term performance, which is monitored within each activity group at the Service level, the Accumulated Operating Result (AOR) is computed. The AOR takes into consideration the results of previous years' NORs (losses and gains of prior years) to determine projected annual stabilized rates.

Like the NOR, the AOR's target is to break-even. For example, if an activity's NOR resulted in a profit, the projected stabilized rate for the following year would be decreased. On the other hand, if the NOR resulted in a loss, the projected stabilized rate would increase. Based on the outcome of a given fiscal year's AOR, adjustments to prices will fluctuate in order to recoup accumulated losses from, or return accumulated profit to, the customers (Naval Financial Management Career Center, 1997).

The Department of the Navy's Working Capital Fund (NWCF)

Currently, within the DoN's WCF there are nine-activity groups:

1. Base Support;
2. Depot Maintenance - Aircraft;
3. Depot Maintenance - Marine Corps;
4. Depot Maintenance - Ships;
5. Information Services;
6. Ordnance;
7. Research and Development;
8. Supply Management; and
9. Transportation (Defense Technical Information Center, 1999).

The scenario given for a base support activity illustrates how the DoN's WCF is intended to work. The process begins with the project order (Order For Work and Service: NAVCOMPT Form 2275) generated by the customer. The project order delineates the following information:

1. The customer (i.e., approving authority);
2. The WCF activity;
3. Work Completion Date;
4. Description of work to be performed;
5. Appropriation code;
6. Dollar amount for the ordered work and/or service; and
7. Billing address (e.g., Defense Finance and Accounting Service) (Naval Financial Management Career Center, 1997).

The activity reviews and accepts, or declines the project order. If the project order is accepted, the support activity generates revenues by billing customers at predetermined prices for the performance of specifically agreed upon work. The total charge is based upon the stabilized rate times the actual workload (i.e., labor hours). Customers are responsible for paying for the work they requested using their operating expense fund (e.g., O&M, RDT&E, etc.). The activity uses these revenues to finance the cost of providing goods and services and to replenish the WCF.

DoD policy requires activity groups to adjust their prices in order to recoup accumulated losses from, or return accumulated profit to, their customers. This DoD policy causes major price fluctuations from one fiscal year to the next and drives some customers to find other sources to provide the goods and/or services. Figure 1 illustrates the WCF process (GAO, March 1997).

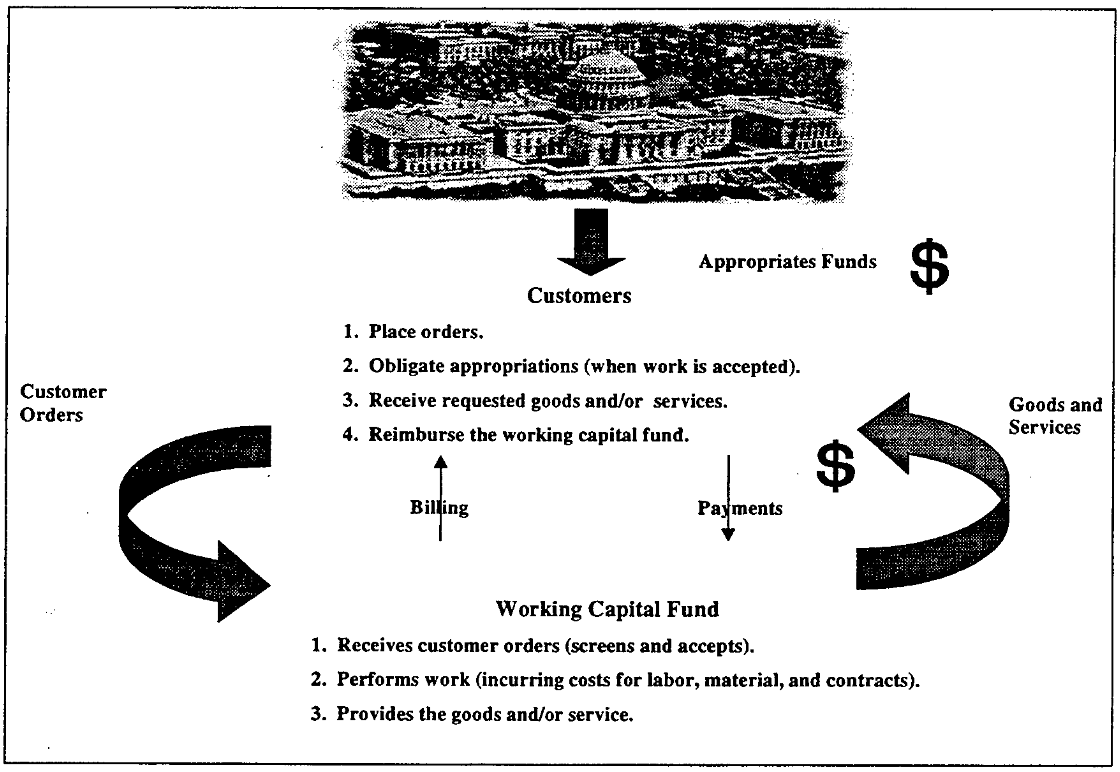

Figure 1 - Working Capital Funds

Causes of Losses in the Business Base

Since 1993, the DBOF has had a cash shortage. The DoD has consistently experienced losses in the operations of various business areas and has had to request additional funding from Congress to support these operations (GAO, May 1997).

The General Accounting Office (GAO) has identified some of the primary causes of activity group losses:

1. Overly optimistic productivity assumptions;

2. Unrealistic cost-reduction goals; and

3. Lower-than-expected workloads (GAO, May 1997).

Activity group losses would occur if there were higher-than-expected costs or lower-than-expected customer demand for goods and services. The problem with estimating sales prices for the requested goods and/or services is that it is not based on actual costs. The activity group will incur a loss if there are higher-than-expected costs, or lower-than-expected customer demand for the goods and/or services. If lower-than-expected costs or higher-than-expected workloads occur, it is possible that the activity group would make a profit (GAO, May 1997).

This is the situation facing Depot operations. One of the factors preventing the DoD from achieving expected savings in its depot maintenance costs includes excess capacity, which contributes to inefficiencies and higher costs. Another factor is that outsourcing is not achieving expected savings. Lastly, inefficiencies in the depot supply system increase the cost of materials and cause disruptions in depot maintenance operations (GAO, May 1997).

DoD's depot maintenance workload has declined significantly. This is primarily caused by the downsizing of the military force structure and reductions in spending for new weapon systems and equipment. Other factors that have contributed to this decline are increased repairs on field-level equipment performed by the Services and the increased requirement for maintainability of some systems and equipment (GAO, May 1997).

The main cause of the Navy Ordnance Activity Group losses has been higher-than-expected overhead costs. Because budgets are prepared 18 to 20 months before the beginning of the fiscal year, the activities have not been able to accurately estimate overhead costs. Navy Ordnance officials report three major reasons for the higher-than-expected overhead costs. First, new and unanticipated costs were incurred that were previously financed with other appropriations or by the Navy's major commands. Second, productivity and cost reduction goals that were incorporated into their budgets by Navy and the DoD budget officials were not met. Third, managers have not been able to reduce the size of their workforce quickly enough to respond to declining workloads, especially when unanticipated workload shortfalls occur (GAO, March 1997).

Impact of Losses on the Business Base

The Depot Maintenance-Ships (shipyards) Activity Group had an accumulated operating result (AOR) loss of $100 million at the end of fiscal year 1998 (GAO, May 1997). Workload delays and cancellations caused this operating loss in the NWCF. In one case, the Navy's budget submission was based partly on the assumption that repairs and alterations for one ship would require 491,000 direct labor hours. Prior to starting the requested work, a major portion (approximately 71 percent) of the work was postponed. The revenues lost from this delayed work equated to an estimated $20 million of direct labor, overhead and surcharge costs (GAO, May 1997).

As customers order less work, activity groups are forced to allocate more overhead costs to each unit of work that is to be completed over that period of time. The DoD's operating environment is constantly struggling with declining work and increasing prices. The Under Secretary of Defense (Comptroller) had stated,

> DoD's inability to reduce infrastructure costs as fast as customers budgets are being reduced is at the center of the dilemma. Since customers are paying higher prices for needed goods and services and they have a finite amount of funds, their overall demand for work is decreasing (GAO, March 1997).

Higher prices force customers to shift work from Navy activity groups to other sources that offer lower costs. In some cases customers are shifting work from the activity group to non-working capital fund activities that are not required to charge the full cost of doing business. This situation creates a competitive disadvantage for the activity group.

One example of this is the calibration maintenance of the Mark 48 torpedo support equipment. This work was previously performed for the customer by the Yorktown Naval Weapons Station (a NWCF activity). It is now being performed by another mission-funded activity located in the Norfolk, Virginia area for one-third the cost (GAO, March 1997). However, while the cost to the customer appears to be lower, it is the same cost to the DoD. Simply stated, the customer pays for only the incremental direct cost, while the remaining costs are mission funded by the Navy.

When customers seek non-WCF activities to provide services and produce goods at lower prices, activity groups are forced to increase prices. The term "death spiral" of demand becomes a reality for many of the DoN's activity groups. Since the DoD's WCF policy requires that operating losses be recouped in future year rates, these increased rates are passed on to the customers. As prices increase, customers tend to seek out alternative non-WCF activities that offer lower prices. As customers eliminate or reduce their demand for goods and/or services, fewer units are produced by the activity group. As this declining trend of production continues, the activity is continually forced to allocate their fixed and overhead costs to fewer customers, which increases the price even further. As the price increases, more customers are driven away from the activity groups, further accelerating the "death spiral" phenomenon.

Activity groups that have been affected by this phenomenon are the Navy Ordnance, Defense Printing, and Defense Clothing Factory. According to Mr. Thomas Lavery, Office of Under Secretary of Defense (Comptroller), the death spiral does occur, evidenced by decreased workload and the elimination of the activity groups listed above. Mr. Lavery projects that the Navy Ordnance activity will no longer be in existence by the end of this year. The closures of Naval Weapons Station, Concord, California and Naval Weapons Station Earle, Portsmouth, Virgina have contributed to this declining workload. Mr. Lavery further commented that the Defense Printing Service maybe in a death spiral because its workloads are also shrinking. Lastly, the Defense Clothing Factory business area was disestablished because of the Base Realignment and Closure (BRAC) in 1994 (Lavery, 1999).

Conclusion

In summary, the purpose of the DoN's WCF is to offer its customers (other DoD and non-DoD agencies) goods and services at low prices on a reimbursable basis. However, as previously mentioned, there are several problems associated with maintaining the WCF (e.g., the "death spiral" phenomena). Moreover, as reductions in the workloads at our military depots increase; this may jeopardize the DoN's ability to maintain capabilities and to support mobilization conditions by utilizing the WCF concept.

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APPENDIX M. PROPERTY ACCOUNTING

As mandated by the Federal Managers' Financial Integrity Act (FMFIA) of 1982, federal agencies are to provide "reasonable assurance" towards the safeguarding of funds and assets and accurate reporting of funds entrusted to each agency. In addition, the Department of Defense (DoD) requires that assets will be under continuous accounting controls from time of acquisition to disposition. Because of these requirements, the DoD has an obligation to protect its property from fraud, waste, abuse, theft and unauthorized use. The purpose of setting strict guidelines for accounting for government property and equipment is to insure that public funds are properly used (Under Secretary of Defense (Comptroller), January 1995).

This appendix is designed to outline the requirements of the four classes of plant property and minor property. Furthermore, this appendix will discuss the purpose of the automated property accounting system, DPAS, and the role it plays in maintaining property accountability, utilization, and scheduling of preventive maintenance.

Plant property, which is known as real or personal property, is categorized under four separate classes. The term "real" refers to land and buildings, while the term "personal" refers to equipment. For an item to be classified as plant property, it must have an acquisition value equal or greater than $100,000 and have a useful life of two years or more. Property previously purchased at previous lower thresholds will be converted to minor property. For example, property acquired when the threshold was set at $15,000 in 1989 is converted to minor property (Defense Finance and Accounting Service, May 1998).

Class 1

Assets that fall under Class 1 are DoD-controlled land. The acquisition cost of the land determines its value. If the acquisition cost cannot be determined, the fair market value will be used to estimate its value. Since the DoD considers land as a non-wasting asset, the value of the land is not to be depreciated. A physical inventory of real property is required every five years (Under Secretary of Defense (Comptroller), September 1999).

Class 2

Assets classified under Class 2 are real property improvements to land (e.g., buildings, structures and facilities, utilities, and construction-in-progress). For buildings to be classified under class 2 they must be a DoD controlled asset that provides future benefit to the organization's operation. The DoD controlled buildings are to be valued at the cost at purchase. In cases where acquisition costs cannot be determined, the fair market value of the building is to be used. Structures and facilities that fall under class 2 are DoD controlled utilities, ground improvements, and facilities that are not considered buildings. This also includes any equipment permanently built-in to structures that would otherwise be classified as Class 3 or 4.

Construction-in-progress accounts are the accumulated costs of DoD real property construction projects. The cost to construct the asset is recorded as construction-in-progress until it is completed and placed in service. At the time of completion of construction, the construction-in-progress account is to be transferred to the General Plant, Property & Equipment account. A physical inventory of real property is required every five years (Under Secretary of Defense (Comptroller), September 1999).

Class 3

Assets classified under Class 3 are equipment (e.g., Magnetic Resonance Imaging (MRI) machines) owned by the DoD, excluding industrial plant equipment (Under Secretary of Defense (Comptroller), 1995).

Every three years a physical inventory is required to verify the location and condition of equipment. The Commanding Officer has the option to mandate these inventories on a more frequent basis. The results of these inventories are used to reconcile the property accounting records with the activity's fiscal office. For example, the Naval Postgraduate School's fiscal office is Defense Finance and Accounting Service, Charleston. Any noted differences between the results of the physical counts and property records are to be researched and reported up the chain of command. Lastly, the property records are to be adjusted for items that were not identified during the physical inventory. If physical inventories were not properly conducted and/or property records were not properly reconciled as prescribed, this would be considered a material weakness in accordance to the Federal Managers' Financial Integrity Act of 1982 (Under Secretary of Defense (Comptroller), 1995).

Class 4

Assets classified under Class 4 are Industrial Plant Equipment (IPE) and are considered to be personal equipment. Other IPE considered under this classification are special tooling or special test equipment. Special tooling comprises manufacturing apparatus used for the production of specific items or providing a unique service. Special test equipment is also specialized in nature. Its functions are limited to production testing, development of specific items, or the provision of a unique service. This class of equipment is subject to the same inventory requirements as Class 3 (Under Secretary of Defense (Comptroller), 1995).

Minor Property

Unlike plant property, minor property has less formal controls. Minor property, also known as personal property, is considered to have a useful life of less than two years and is comprised of classified, sensitive, or pilferable items. The funding threshold for minor property typically falls between $2,500 and $100,000. Property valued between $300 and $2,500 is considered minor property if it is classified, sensitive or pilferable.

Classified Equipment

Classified equipment includes items that require a high level of protection and control in order to maintain a degree of national security.

Sensitive Equipment

Sensitive equipment includes items that require a high degree of protection and control because of mission requirements.

Pilferable Equipment

Pilferable equipment (e.g., televisions, video players) are items that can be concealed and easily removed from an authorized area with the intent for personal use or resale (Defense Information Systems Agency Acquisition, Logistics, and Facilities, 1999).

The activity's Financial Manager generally is appointed as the Minor Property Administrator. The Financial Manager's responsibilities include establishing local procedures for managing, controlling, and accounting for minor property. The Minor Property Administrator's duties include publishing triennial inventory requirements and performing periodic minor property procedure reviews. All minor property is to be physically marked (e.g., tagged or labeled) indicating that it is U.S. Navy minor property. (Defense Information Systems Agency Acquisition, Logistics, and Facilities, 1999).

Designated individuals within a Command, also known as responsible officers, are responsible for the minor property within their designated area of responsibility. The minor property administrator will periodically distribute inventory lists to minor property responsible officers. The inventory lists are to be used for conducting triennial inventories and transferring accountability for minor property upon the relief of a responsible officer. Responsible officers are also required to generate the Missing, Lost, Stolen, or Recovered Report (MLSR), Report of Survey DD 200, when minor property is missing, lost, stolen or damaged beyond economic repair (Defense Information Systems Agency Acquisition, Logistics, and Facilities, 1999).

Records and Reports

Commands are to notify the Naval Facilities Engineering Command and the Navy Facility Assets Data Base (NFADB) of any real property accountability changes (e.g., Class 1 and Class 2 property). The Naval Facilities Engineering Command is to provide Navy and Marine Corps activities with technical advice and assistance on the maintenance and operation of facilities and handle the acquisition and disposal of real estate. In addition, the Naval Facilities Engineering Command is responsible for maintaining the real property inventory (Defense Link, October 1998).

The comptroller at the field level is responsible for Classes 3 and 4 and minor property recordkeeping.

The Defense Property Accountability System (DPAS)

As previously mentioned in Appendix B, the DoD continues to struggle with proper accountability of physical asset identification (GAO, January 1999). To respond to the General Accounting Office's report, the DoD Comptroller has directed the utilization of a standard automated property accountability system to rectify the property accountability deficiency. The system to be implemented is the Defense Property Accountability System (DPAS).

In fiscal year 1990, the DoD recognized that real and personal property accounting was a high risk area. As this area was further investigated, the Federal Managers' Financial Integrity Act (FMFIA) Annual Statement of Assurance for fiscal year 1993 confirmed that real and personal property accounting was one the DoD's five high risk areas. To implement a solution to the noted property accountability shortfall, all property and equipment with a useful life of two years or more is to be recorded under general ledger control. A general ledger is a component of a data model that describes how information in an agency's financial systems (e.g., account balances with related records at the transaction level) are recorded to track and estimate total asset values (U.S. Department of Treasury, 1999).

In addition, these assets will be included in the financial statements at the department level accounts. Financial statements will also include footnotes disclosing the methods used for asset valuation.

DPAS provides the system user with general ledger control and pertinent property accountability information (e.g., accounting for and reporting of assets and the capability to compute depreciation). The system's primary functions include all action related to property management, financial accountability, equipment utilization, preventive maintenance schedules, and warranty information. In addition, the DPAS equipment bar code capability supports accounting for assets and an automated means of conducting inventories (e.g., receipts, turn-in, and inventory tracking/status) (Defense Property Accountability System, No Date).

In conclusion, the management of property accounting is an essential area of financial management. The DoD is responsible for the accountability of billions of dollars of assets and to date, the DoD has been unable to properly track and estimate total assets value. As a response to deficiencies noted in the GAO reported dated 1999, the DoD has implemented the DPAS as a solution to resolve the property accountability problems.

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